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No. 82-435

IN THE

Supreme Court of the United States

October Term, 1982

COMMONWEALTH EDISON COMPANY, *ET AL.*,
Petitioners,

v.

UNITED STATES OF AMERICA and
INTERSTATE COMMERCE COMMISSION,
Et Al., Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE
DISTRICT OF COLUMBIA CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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Of Counsel

September, 1982

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QUESTIONS PRESENTED

1. Where a statute directs the Interstate Commerce Commission to determine the increase in railroad costs on a quarterly basis and authorizes the railroads to increase rates by the amount so determined, and the Commission adopted a procedure that it knew would result in authorized increases in excess of the increases in railroad costs, did the Court below have a duty to set aside the Commission decision?

2. Where the Interstate Commerce Commission adopted the Association of American Railroads Index of Railroad Material Prices and Wages as the measure of increases in cost, and declined, as a matter of policy, to adjust that index for changes in productivity although it conceded that it could make such an adjustment, and the Court below found that the alleged policy reasons were invalid, did the Court err in sustaining the Commission based on the Court's view as to the difficulties involved in making a productivity adjustment?

LIST OF PARTIES

This Petition is being filed on behalf of the following: Commonwealth Edison Company;[1] Madison Gas and Electric Company;[2] Pennsylvania Power & Light Company;[3] Wisconsin Power & Light Company;[4] and Wisconsin Public Service Corporation[5].

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[1]*Subsidiaries and Affiliates:* Chicago & Illinois Midland Railway Company; Commonwealth Edison Company of Indiana, Inc.; Commonwealth Research Corporation; Concomber, Inc.; Cotter Corporation; Edison Development Company; Edison Development Company Canada, Inc.; Medical Center Steam Company; and 72 West Adams Company.

[2]*Subsidiaries & Affiliates:* Madison Gas & Electric Foundation, Inc., Madison Gas & Electric; Nuclear Fuel, Inc.; Magael, Inc.; and Magael Material Resources, Inc.

[3]*Susidiaries & Affiliates:* The Arcadia Company, Inc.; BDW Corporation; Court Development Company; Greene Hill Coal Company; Greene Manor Coal Company; Hanover Development Company; Interstate Energy Company; LCA Leasing Corporation; The Oneida Mining Company; Pemico, Inc.; Pennsylvania Mines Corporation; Realty Company of Pennsylvania; Rushton Mining Company; Service Development Company; Tunnelton Mining Company; and Uranium Resources and Development Company.

[4]*Subsidiaries & Affiliates:* Nufus, Inc.; South Beloit Water, Gas & Electric Company; Wisconsin Power & Light; Nuclear Fuel, Inc.; and Wisconsin River Power Company.

[5]*Subsidiaries & Affiliates:* Dolors Bench General Partners.

The following were also parties to the proceeding in the United States Court of Appeals for the District of Columbia Circuit:

Alabama Power Company
American Iron & Steel Institute
American Paper Institute
Arkansas Power & Light Company
Association of American Railroads
Carolina Power & Light Company
Central Illinois Light Company
Chemical Manufacturer's Association
Duke Power Company
Edison Electric Institute
The Fertilizer Institute
Fort Howard Paper Company
Georgia Power Company
Gulf Power Company
Interstate Commerce Commission
Louisiana Power & Light Company
Middle South Utilities System
Mississippi Power & Light Company
Mississippi Power Company
Nevada Power Company
New Orleans Power Service, Inc.
Potomac Electric Power Company
Public Service Company of Indiana, Inc.
South Carolina Electric & Gas Company
South Carolina Public Service Authority
Southern Company Services, Inc.
The National Industrial Traffic League
United States of America
Virginia Electric and Power Co.
Western Coal Traffic League
Wisconsin Electric Power Company

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
LIST OF PARTIES	ii
TABLE OF CONTENTS	iv
TABLE OF AUTHORITIES	v
OPINIONS BELOW	1
JURISDICTION	2
STATUTORY PROVISIONS INVOLVED	2
STATEMENT	2
REASONS FOR GRANTING THE WRIT	6
CONCLUSION	12

PET. APP. A

Decision of the Court of Appeals in *Western Coal Traffic League* v. *United States,* 677 F.2d 915 (D.C. Cir. 1982)

PET. APP. B.

June 15, 1982 Order denying Petition for Rehearing

PET. APP. C

Decision of the Interstate Commerce Commission, 364 I.C.C. 841 (1981)

PET. APP. D

49 U.S.C. §10707a, 49 U.S.C. §10709

PET. APP. E

Interstate Commerce Commission Advanced Notice of Proposed Rulemaking, issued on July 23, 1982

TABLE OF AUTHORITIES

Page

CASES:

Atchison T. & S. F. Ry. Co. v. *Wichita Board of Trade*, 412 U.S. 800 (1973) 8

Ex Parte No. 393, *Standards for Railroad Revenue Adequacy*, 364 I.C.C. 803 (1981) on review *sub nom. Bessemer & Lake Erie R.R. Co.* v. *ICC*, No. 83-1492 (3rd Cir. filed March 31, 1981) 5

FPC v. *Idaho Power Co.*, 344 U.S. 17 (1952) 9

SEC v. *Chenery Corp.*, 317 U.S. 80 (1943) 8

Western Coal Traffic League v. *United States*, 677 F.2d 915 (D.C. Cir. 1982) ..... *passim*

STATUTES:

28 U.S.C. §1254(1) 2

Staggers Rail Act of 1980, Pub. L. No. 96-448 94 Stat. 1895 2

49 U.S.C. §10707a(a) 2
49 U.S.C. §10707a(a)(2)(B) 3, 4, 7
49 U.S.C. §10707a(b) 2
49 U.S.C. §10707a(b)(2) 3
49 U.S.C. §10707a, (c), (d), (e), (f) (g), (h) 2, 4, 6
49 U.S.C. §10709(a) 2
49 U.S.C. §10709(a)(2) 6
49 U.S.C. §10709(d)(2) 9, 10
49 U.S.C. §10709(d)(5)(B) 3

MISCELLANEOUS

Staggers Rail Act of 1980: Hearing on S. 1946 Before the Senate Comm. on Commerce, Science and Transportation, 96th Cong., 1st Sess. (1979) at 435 7

No. _____

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COMMONWEALTH EDISON COMPANY, *ET AL.*,
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v.

UNITED STATES OF AMERICA and
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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

PETITION FOR WRIT OF CERTIORARI

Petitioners Commonwealth Edison Company, Madison Gas and Electric Company, Pennsylvania Power & Light Company, Wisconsin Power & Light Company and Wisconsin Public Service Corporation respectfully pray that a writ of certiorari issue to review the Judgment and Opinion of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The decision of the Court of Appeals is reported as *Western Coal Traffic League* v. *United States*, 677 F.2d 915 (D.C. Cir. 1982) and appears as Appendix A to this Petition (Pet. App. A). The decision of the Interstate Commerce Commission which the Court of Appeals affirmed is reported at 364 I.C.C. 841 (1981) and appears at Pet. App. C.

JURISDICTION

The decision of the Court of Appeals, which constitutes its judgment in this case, was entered May 4, 1982. A timely Petition for Rehearing was denied by order entered June 15, 1982, which appears at Pet. App. B. The Court has jurisdiction to review the decision below under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

The basic statutory provision involved is 49 U.S.C. §10707a(a) (b) which appears at Pet. App. D. Also included in Pet. App. D are the following statutory provisions which are relevant to the questions presented:

49 U.S.C. §10707a, (c), (d), (e), (f), (g), (h); and 49 U.S.C. §10709.

STATEMENT

The Staggers Rail Act of 1980, Pub. L. No. 96-448,94 Stat. 1895 (1980) (the Act or the Staggers Act) deprived the Interstate Commerce Commission (Commission) of jurisdiction to pass on the maximum reasonableness of most railroad rates. It established a threshold below which the Commission would have no jurisdiction and further provided that, even as to rates above the threshold, Commission jurisdiction would extend only to rates for transportation over which the carrier possessed market dominance, defined as "an absence of effective competition from other carriers or modes of transportation for the transportation to which a rate applies." 49 U.S.C. §10709(a). The threshold was fixed at 160 percent of variable cost for the 12 months ending September 30, 1981, increasing 5 percentage points each 12 months thereafter until the "cost recovery percentage" takes over on October 1, 1983 or October 1, 1984.[1]

[1]For the 12 months begining October 1, 1983, the threshold is 175 percent of variable cost or the cost recovery percentage, whichever is less. For subsequent periods, the threshold is the cost recovery percentage but not less than 170 nor more than 180 percent of variable cost.

The Staggers Act establishes the rate in effect on October 1, 1980 as the base rate for an initial two year period.[2] The rates in effect on October 1, 1982, on October 1, 1984, and on October 1 of every fifth year thereafter become new base rates.

Section 203 of the Staggers Act contains two provisions authorizing increases in those base rates over which the Commission has jurisdiction. The Act directs the Commission to publish at least quarterly:

> a rail cost adjustment factor which shall be a fraction, the numerator of which is the latest published Index of Railroad Costs (which index shall be compiled or verified by the Commission, with appropriate adjustments to reflect the changing composition of railroad costs, including the quality and mix of material and labor), and the denominator of which is the same index for the fourth quarter of 1980, or for the fourth quarter of 1982 or for the fourth quarter of every fifth year thereafter, as appropriate. (49 U.S.C. § 10707a(a)(2)(B), Pet. App. D at 2))

Railroads have an absolute right to increase rates by the rail cost adjustment factor, and such increases cannot be challenged. (49 U.S.C. § 10707a(a)(b)(2), Pet. App. D at 2.)

In addition to the increases resulting from application of the rail cost adjustment factor, a railroad can increase rates, during the first 48 months after the October 1, 1980 effective date of the Staggers Act, by 6 percent in each 12 month period but not more than a total of 18 percent; and a railroad that has not achieved "revenue adequacy" as determined by the Commission can increase rates by 4 percent in each 12 month period thereafter. Such increases

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[2]Under Section 229 of the Staggers Act (49 U.S.C. §10709(d)(5)(B)), the base rate could be challenged within 180 days of the effective date of the Act but not thereafter.

may be challenged by complaint with the burden of proof on the shipper (49 U.S.C. §10707a(c) (d) (e); Pet. App. D at 2).

The initial draft of 49 U.S.C. §10707a(2) (B) had directed the Commission to use an "Index of Railroad Material Prices and Wages", which is the title of the index put out by the Association of American Railroads (the AAR Index). There was substantial shipper opposition to this provision, witnesses pointing out that the AAR Index made no adjustment for changes in productivity and overstated increases in cost. The language above quoted i.e., "with appropriate adjustments to reflect the changing composition of railroad costs, including the quality and mix of material and labor" was substituted by the Congress in response to such representations.

The AAR Index is an "input" index of the prices paid by railroads for wages and materials,[3] and not an "output" index of the railroads' costs of operation. In its decision in the rulemaking proceeding below, the Commission conceded that "productivity increases cause the costs of outputs to rise less rapidly than the costs of inputs...." (Pet. App. C at 6). It also conceded that "methodological problems of productivity measurement alone (although grave) do not preclude the development of productivity measures." (Pet. App. C at 6.) It continued, "We nevertheless question the reliability of such measures and as a matter of policy do not believe that their use is justified." (Pet. App. C at 6.)

After discussing its policy reasons, the Commission stated "In sum we will not adjust the rail cost index to reflect productivity gains as long as the railroad industry continues to earn inadequate revenues." (Pet. App. C. at 7.)

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[3]The existing AAR Index covers only 72 percent of price inputs. As a temporary surrogate for the 28 percent not covered by the AAR Index, the Commission decided to use the Producer Price Index. This temporary expedient is not involved in the questions here presented.

The Court of Appeals found the Commission decision "only minimally adequate." (Pet. App. A at 28.) It analyzed the policy reasons on which the Commission relied and rejected all of them. Nevertheless, although the Commission had conceded the feasibility of productivity adjustments and had rejected them solely on policy grounds, the Court of Appeals stated:

> We conclude that within the present state of the art—at least as reflected in this record—the difficulties of accurately measuring productivity growth on a current basis, coupled with the Commission's assessment of the importance of assuring railroads unencumbered rate increases to cover increased costs, support the Commission's conclusion that a productivity adjustment is inappropriate under present circumstances. (Pet. App. A at 35-36.)

In the face of the Commission's statement that it would not consider productivity gains so long as the railroad industry was earning inadequate revenues,[4] the Court continued:

> We expect, however, that in accordance with its stated intentions, the Commission will continuously review the accuracy of its chosen index and will revise the index in an appropriate fashion, including consideration of measurable productivity gains, as the circumstances warrant. (Pet. App. A at 36.)

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[4]This statement must be read in connection with the Commission's decision in Ex Parte No. 393, *Standards for Railroad Revenue Adequacy*, 364 I.C.C. 803 (1981), in which the Commission established standards of revenue adequacy that very few corporations could meet. Even the most prosperous of the nation's major railroads were found not to be revenue adequate. That decision is under review in *Bessemer & Lake Erie R.R.* v. *ICC*, No. 81-1492, *et al.* (3rd Cir. filed March 31, 1981).

REASONS FOR GRANTING THE WRIT

The Court below affirmed a Commission decision that squarely violates the statute by establishing rail cost adjustment factors that exceed increases in cost, and that will raise effectively and continuously the revenue/variable cost thresholds established by 49 U.S.C. §10709 (a) (2), which must be equaled or exceeded before the Commission can exercise jurisdiction over the maximum level of rates. The emasculation of the jurisdictional thereshold provision will permit monopolistic exploitation of shippers of commodities that are captive to the railroads and will cause incalculable harm to the nation's electric utilities and the customers they serve.

1. The sole purpose of the rail cost adjustment factor is to enable railroads to recover without delay increases in cost resulting from inflation. Other provisions of the statute provide ample authority to increase rates for other purposes (49 U.S.C. §10707a (c), (d)).[5] The legislative history makes this clear and the Court below so understood. The Court pointed out that in all the testimony at the Senate Hearings

> no one suggested that the function of the inflationary cost index was anything other than to provide a rapid mechanism for translating cost increases into rate increases. This view of the underlying purpose of the inflation index was reaffirmed when S. 1946 was reported out of committee. (Pet. App. A at 24.)

The Court further said that "we agree with petitioners that the *purpose* of section 203 was to allow railroads to keep up with cost increases . . . ." (Emphasis in original, Pet. App. A at 25.) So far, so good, but the Court went on to

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[5]The provisions authorizing rate increases are relevant only as to the relatively small amount of traffic over which the railroads possess market dominance. Rates on competitive traffic can be raised at will. See *supra*, p. 2.

interpret the statute as permitting the Commission to adopt knowingly and deliberately an index that greatly overstates increases in costs.[6]

In support of this misinterpretation of the statute, the Court stated that a secondary Congressional purpose was establishment of a cost recovery mechanism that would "avoid regulatory lag by operating with dispatch to assure that rates actually reflect current costs" (Pet. App. A at 23.) However, the Congressional objective of avoiding regulatory lag was to be accomplished by means of the requirement that the cost adjustment factors be published "as often as practicable but, in any event, no less than quarterly" (49 U.S.C. §10707a(a) (2) (B)). The objective of compensating the railroads for their increases in costs was to be accomplished by a cost adjustment factor that would compensate for increases in cost but *only* for increases in cost. The Court below confused the two objectives of "operating with dispatch" and "assur[ing] that rates actually reflect current costs." The Commission did not, and could not consistent with the statute, justify the use of an index which overstates costs on the ground that its use would prevent regulatory lag.

2. The Commission conceded that the development of productivity measures was feasible but rejected their adoption for policy reasons. The Court below carefully

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[6]The uncontradicted evidence in the record is that the overstatement of cost is substantial. For the years 1970 to 1978, the average annual increase in freight unit costs was only 66 percent of the increase in the AAR Index. (J.A. 816.) For the same 9 years, the average annual increases in the Consumer Price Index, the Producer Price Index and the GNP Implicit Price Deflator were, respectively, 63 percent, 79 percent and 62 percent of the average increase in the AAR Index. (J.A. 818.) The Western railroads have conceded that the AAR Index overstates railroad costs by 25% by basing escalation agreements on 80% of the Index. Staggers Rail Act of 1980: Hearings on S. 1946 before the Senate Comm. on Commerce, Science, and Transportation, 96th Cong., 1st Sess. (1979) at 435.

analyzed the policy reasons given by the Commission and rejected all of them (Pet. App. A at A-31-35). It then affirmed the Commission on the basis of its own views as to the difficulties of accurately measuring changes in productivity. In so doing, the Court erred in two respects. It invaded the primary jurisdiction of the Commission by substituting its judgment for that of the Commission on a factual issue, *See Atchison T. & S. F. Ry. Co.* v. *Wichita Board of Trade,* 412 U.S. 800 (1973), and it sustained the Commission order on a ground on which the Commission had not relied. *See SEC* v. *Chenery Corporation,* 317 U.S. 80 (1943).

3. The Court below seems to have construed the Commission's decision as an interim decision to be judged by the less stringent standards that apply to such decisions. Despite the Commission's statement that "we will not adjust the rail cost index to reflect productivity gains so long as the railroad industry continues to earn inadequate revenues," the Court below construed the decision as containing a commitment "to review the index against current cost data, taking appropriate action in the event of over recovery" (Pet. App. A at 31). We are unable to find such a commitment in the decision. The Commission said it would check for errors,audit underlying data and compare the AAR Index with other data sources (Pet. App. C at 3) but this is a far cry from a commitment to determine whether the AAR Index overstates cost increases and to take action in the event of over recovery.[7]

If an agency decision is erroneous, as was the Commission decision here, a court has a duty to remand the

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[7]There are methods of determining after-the-fact whether an index has overstated or understated increases in cost. One method would be to take a random sample of railroad traffic, cost it out on an annual basis and compare the increase in cost over the last 12 months with the increase produced by applying the rail cost adjustment factor. The Court did not require the Commission to make such a determination and the Commission does not propose to do so.

decision to the agency for correction. As stated in *FPC* v. *Idaho Power Co.*, 344 U.S. 17, 20 (1952): "the guiding principle . . . is that the function of the reviewing court ends when an error is laid bare. At that point, the matter once more goes to the Commission for reconsideration." An affirmance with simply precatory language leaves the agency free to correct its error or not as it sees fit.[8]

4. This case is of supreme importance to shippers of the few, but important, commodities that are captive to the railroads. The electric utility industry consumes a large portion of the coal mined in the United States and much of that coal is shipped for long distances over the railroads. There is no alternative to rail transportation for most movements of coal. Unless subjected to statutory or regulatory constraint, the railroads are free to price such traffic at monopoly levels. In enacting the Staggers Act, Congress sought to reconcile the need of the railroads for freedom in competitive markets with the need of captive shippers to be protected from monopolistic exploitation. One important place where this compromise is reflected is in the Jurisdictional threshold (49 U.S.C. §10709(d) (2)), which permits the railroads to charge rates much higher than they charge on competitive traffic but puts a limit on the extent to which they can engage in monopoly pricing without encountering regulatory control.

The effect of a rail cost adjustment factor that overstates increases in cost is to increase the effective threshold of

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[8]In an apparent response to the precatory language of the Court below, the Commission issued an Advance Notice of Proposed Rulemaking on July 23, 1982 which requested comments on "the possible use of the productivity adjustment in determining the quarterly rail cost adjustment factor and proposals for measuring productivity and for implementing a productivity adjustment." (Pet. App. E at 3.) This advance notice gives the shippers no assurance that a rulemaking proceeding will even be instituted. It certainly gives them assurance that a productivity adjustment will ever be adopted or when such an adjustment will be adopted.

Commision jurisdiction and to write out of the Act the protection against excessive monopoly exploitation that Congress thought it was giving to captive shippers.

Over time, a cost adjustment factor that is greater than the increase in railroad costs will insulate from regulation rates far in excess of the statutory jurisdictional threshold because neither the base rate nor a cost adjustment factor increase can ever be challenged by a shipper. This can be demonstrated readily. Assume that the threshold of Commission jurisdiction will be a revenue/variable cost ratio of 180% when the cost recovery percentage becomes the threshold,[9] and that the rail cost adjustment factor is derived from the AAR Index. Assume further that a rate that year is $1.80, that the variable cost of the service is $1.00, and that in the next year the AAR Index increases by 10% but the railroad's actual costs increase only 8%[10] The rate would thus become $1.98 ($1.80 x 1.10) but the variable cost would have risen only to $1.08 ($1.00 x 1.08). The revenue/variable cost ratio,and therefore the effective jurisdictional threshold, would become 183.3% ($1.98 divided by $1.08). In succeeding years, if the same situation continued each year, the increases in the effective threshold would be as shown below:

	Cost	*Rate*	*Effective Threshold*
Base Year	$1.00	$1.80	180%
Year 1	$1.08	$1.98	183.3%
Year 2	$1.166	$2.18	187%
Year 3	$1.259	$2.40	190.6%
Year 4	$1.36	$2.64	194.1%
Year 5	$1.469	$2.90	197.4%
Year 10	$2.158	$4.68	216.9%

[9]Beginning October 1, 1984, the cost recovery percentage will be the jurisdictional threshold only if it falls between 170 and 180 percent of variable cost. If it is less than 170 the threshold is 170 and if it is more than 180 the threshold is 180. 49 U.S.C. §10709(d)(2). The cost recovery percentage was found to be 197.5% of variable cost in 1981. 46 Fed. Reg. 20,794, 20,795 (Apr. 7, 1981).

[10]These assumptions are reasonable. See footnote 6, *supra* at 7 n. 6.

Under this scenario, the effective threshold of Commission jurisdiction would rise to a revenue/variable cost ratio of 216.9% at the end of just ten years and would continue to rise each year thereafter. The practical effect is that, over a ten year period, the railroad, without subjecting the rate to Commission jurisdiction, could raise the $1.80 rate to $4.67 per ton whereas it could have raised the rate only to $3.89[11] if the rail cost adjustment factor reflected actual increases in cost. If the increases in the AAR Index and in actual railroad costs are as assumed above, the impact on the consumers of electricity will be substantial. Since current rates on western coal typically exceed $20 per ton, a utility with annual requirements of 10 million tons of western coal will be faced with unjustified cost increases in year 10 in the order of 100 million dollars.

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[11]$1.80 compounded for 10 years at a rate of 8% is $3.89.

CONCLUSION

The Court below declined to set aside a Commission decision that it recognized was seriously flawed and that, if permitted to stand, will effectively write out of the Interstate Commerce Act what little protection the Staggers Act affords to captive shippers. In terms of its effect on shippers, this may well be the most important transportation case this Court has ever been asked to review.

For the reasons stated, certiorari should be granted and the case should be set for briefing and oral argument.

Respectfully submitted,

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September, 1982

Notice: This opinion is subject to formal revision before publication in the Federal Reporter or U.S.App.D.C. Reports. Users are requested to notify the Clerk of any formal errors in order that corrections may be made before the bound volumes go to press.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 81-1437

WESTERN COAL TRAFFIC LEAGUE, PETITIONER

v.

UNITED STATES OF AMERICA AND
INTERSTATE COMMERCE COMMISSION, RESPONDENTS

ASSOCIATION OF AMERICAN RAILROADS,
DUKE POWER COMPANY, ET AL.,
AMERICAN PAPER INSTITUTE, INC.,
CAROLINA POWER & LIGHT COMPANY,
NATIONAL INDUSTRIAL TRAFFIC LEAGUE,
AMERICAN IRON AND STEEL INSTITUTE,
NEVADA POWER COMPANY,
CENTRAL ILLINOIS LIGHT COMPANY, ET AL., INTERVENORS

No. 81-1480

ALABAMA POWER COMPANY, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA AND
INTERSTATE COMMERCE COMMISSION, RESPONDENTS

ASSOCIATION OF AMERICAN RAILROADS,
WESTERN COAL TRAFFIC LEAGUE, INTERVENORS

Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

No. 81-1520

CHEMICAL MANUFACTURERS ASSOCIATION, PETITIONER

v.

UNITED STATES OF AMERICA AND
INTERSTATE COMMERCE COMMISSION, RESPONDENTS

ASSOCIATION OF AMERICAN RAILROADS,
WESTERN COAL TRAFFIC LEAGUE, INTERVENORS

No. 81-1523

COMMONWEALTH EDISON COMPANY, ET AL., PETITIONERS

v.

INTERSTATE COMMERCE COMMISSION AND
UNITED STATES OF AMERICA, RESPONDENTS

ASSOCIATION OF AMERICAN RAILROADS,
WESTERN COAL TRAFFIC LEAGUE, INTERVENORS

No. 81-1547

FORT HOWARD PAPER COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA AND
INTERSTATE COMMERCE COMMISSION, RESPONDENTS

ASSOCIATION OF AMERICAN RAILROADS,
WESTERN COAL TRAFFIC LEAGUE, INTERVENORS

No. 81-1590

EDISON ELECTRIC INSTITUTE, PETITIONER

v.

INTERSTATE COMMERCE COMMISSION AND
UNITED STATES OF AMERICA, RESPONDENTS

WESTERN COAL TRAFFIC LEAGUE,
ASSOCIATION OF AMERICAN RAILROADS, INTERVENORS

No. 81-1639

THE FERTILIZER INSTITUTE, PETITIONER

v.

UNITED STATES OF AMERICA AND
INTERSTATE COMMERCE COMMISSION, RESPONDENTS

WESTERN COAL TRAFFIC LEAGUE,
ASSOCIATION OF AMERICAN RAILROADS, INTERVENORS

No. 81-1642

AMERICAN PAPER INSTITUTE, INC., PETITIONER

v.

UNITED STATES OF AMERICA AND
INTERSTATE COMMERCE COMMISSION, RESPONDENTS

ASSOCIATION OF AMERICAN RAILROADS,
WESTERN COAL TRAFFIC LEAGUE, INTERVENORS

No. 81-1659

CAROLINA POWER & LIGHT COMPANY, PETITIONER

v.

INTERSTATE COMMERCE COMMISSION AND
UNITED STATES OF AMERICA, RESPONDENTS

ASSOCIATION OF AMERICAN RAILROADS,
WESTERN COAL TRAFFIC LEAGUE, INTERVENORS

No. 81-1660

CENTRAL ILLINOIS LIGHT COMPANY, ET AL., PETITIONERS

v.

INTERSTATE COMMERCE COMMISSION AND
UNITED STATES OF AMERICA, RESPONDENTS

WESTERN COAL TRAFFIC LEAGUE,
ASSOCIATION OF AMERICAN RAILROADS, INTERVENORS

No. 81-1661

SOUTH CAROLINA ELECTRIC & GAS COMPANY, PETITIONER

v.

INTERSTATE COMMERCE COMMISSION AND
UNITED STATES OF AMERICA, RESPONDENTS

ASSOCIATION OF AMERICAN RAILROADS,
WESTERN COAL TRAFFIC LEAGUE, INTERVENORS

Petitions for Review of an Order of the
Interstate Commerce Commission

Argued February 2, 1982

Decided May 4, 1982

Judgment entered this date ←

William Lewis Slover, with whom *C. Michael Loftus*, *Donald G. Avery* and *John H. LaSeur* were on the brief, for Western Coal Traffic League and Fort Howard Paper Company, petitioners in Nos. 81-1437 and 81-1547 and intervenors in Nos. 81-1480, 81-1520, 81-1523, 81-1547, 81-1590, 81-1639, 81-1659, 81-1642, 81-1660 and 81-1661.

Charles J. McCarthy, with whom *John M. Cutler, Jr.* was on the brief, for Commonwealth Edison Company, et al., petitioners in No. 81-1523.

Leonard M. Trosten, *Harry H. Voigt*, *Michael F. McBride* and *Daniel J. Conway* were on the brief for Edison Electric Institute, petitioner in No. 81-1590.

Harold E. Spencer, *Stephen C. Herman* and *Richard S. M. Emrich* were on the brief for The Fertilizer Institute, petitioner in No. 81-1639.

John F. Donelan, *John F. Maser, III*, *Frederic L. Wood*, *Nicholas J. DiMichael* and *John F. Donelan, Jr.* were on the brief for Carolina Power and Light Company, et al., petitioners in Nos. 81-1659, 81-1642 and 81-1661, and intervenors in No. 81-1437.

John R. Molm and *Robert P. Edwards, Jr.* were on the brief for Alabama Power Company, et al., petitioners in No. 81-1480.

Edmund B. Frost, *Raymond Michael Ripple* and *Gloria M. Sodaro* were on the brief for Chemical Manufacturers Association, petitioner in No. 81-1520.

J. Raymond Clark and *Mary Todd Foldes* were on the brief for Central Illinois Light Company, et al., petitioners in No. 81-1660 and intervenors in No. 81-1437.

Lawrence H. Richmond, Attorney, Interstate Commerce Commission, with whom *Richard A. Allen*, General Counsel, *Kathleen M. Dollar*, Associate General Counsel, Interstate Commerce Commission, *John J. Powers, III* and

Kenneth P. Kolson, Attorneys, Department of Justice, were on the brief, for respondents.

Robert Eden Martin, with whom *David M. Levy*, *Michael G. Lederman*, *Curtis H. Berg*, *W. Donald Boe, Jr.*, *James L. Howe, III*, *John W. Ongman* and *John J. Paylor* were on the brief for intervenor, Association of American Railroads, in Nos. 81-1437, 81-1480, 81-1520, 81-1523, 81-1547, 81-1590, 81-1639, 81-1659, 81-1642, 81-1660 and 81-1661.

James W. Lawson was on the brief for Nevada Power Company, intervenor in No. 81-1437.

Max O. Truit, Jr. and *Neil J. King* were on the brief for American Iron and Steel Institute, intervenor in No. 81-1437.

C. Michael Loftus was on the brief for Consumer Power Coalition, *amicus curiae*.

Before: WALD, MIKVA and GINSBURG, *Circuit Judges*.

Opinion for the Court filed by *Circuit Judge* WALD.

WALD, *Circuit Judge*: The Staggers Rail Act of 1980, Pub. L. No. 96-448, 95 Stat. 1895 (to be codified in scattered sections of 11, 45 & 49 U.S.C.) ("Staggers Act" or "Act") provides the Interstate Commerce Commission ("ICC" or "Commission") with jurisdiction to review the reasonableness of rates charged by "market dominant"[1] railroads. Under Title II of the Act, however, certain railroad rates and rate increases are deemed reasonable and are thus immune from Commission review. The issues in this case are (1) whether the formula adopted by the Commission for translating cost

[1] The test for market dominance is set forth in section 202 of the Act, 49 U.S.C.A. § 10709(d) (West Supp. 1981). *See* page 2 *infra*. Pursuant to section 201(a), 49 U.S.C.A. § 10701a(c) (West Supp. 1981), the Commission also has jurisdiction to prevent railroads from setting rates below a reasonable minimum.

increases into presumptively reasonable rate increases comports with the statutory description for such a formula and (2) whether the Commission acted arbitrarily and capriciously in selecting among possible formulae. For the reasons set forth below, we find that the Commission acted within its statutory authority and that it offered an adequate rationale for adopting the specific inflationary cost index at issue in this case.

I. BACKGROUND

A. *Statutory Context*

Under the Staggers Act, market dominance of a railroad in a particular market is determined by the ratio of rates to variable costs. If this "revenue-variable cost percentage" exceeds a certain level, the Commission has jurisdiction to review the reasonableness of the rate charged. *See* 49 U.S.C.A. §§ 10701a(b)(1), 10709(d)(2) (West Supp. 1981). This threshold test, set initially at 160% for the year ending September 30, 1981, will increase to 175% for the year ending September 30, 1984.[2]

Rates that met this test of market dominance at the time of the Staggers Act's enactment could have been challenged within 180 days of the passage of the Act. *See* 49 U.S.C.A. § 10701a note (West Supp. 1981). Rates determined in such a proceeding became "base rates" for the applicable service. Similarly rates that were not challenged or were not initially subject to challenge also became base rates. Pursuant to section 203 of the Act, 49 U.S.C.A. § 10707a (West Supp. 1981), these base rates are to be adjusted annually in accordance with an inflation cost index developed or verified by the Commission. The resulting "adjusted base rate"

[2] After September 30, 1984, market dominance will depend on a "cost recovery percentage." *See* 49 U.S.C.A. § 10709(d)(2)(E) (West Supp. 1981).

is not necessarily a rate that is actually charged by any railroad. Instead, it serves as a measuring stick by which the Commission considers the reasonableness of rate increases.[3] Those rate increases that simply follow the inflation adjustment formula are immune from attack. *See* 49 U.S.C.A. § 10707a(b)(2) (West Supp. 1981). Those that exceed the inflation adjustment may be challenged, but the burden of proof in a rate proceeding and the Commission's authority to suspend and investigate rate increases depend on the size of the rate increase as a percent of the adjusted base rate. For the four years following passage of the Act, additional rate increases of six percent or less of the adjusted base rate fall within the railroad's "zone of rate flexibility." For these rate increases, the Commission generally lacks the power to suspend or investigate rates[4] and the burden of proof in a rate proceeding rests on the one challenging the rate's reasonableness.[5] *See* 49 U.S.C.A. § 10701a(b) (West Supp. 1981). For larger rate increases, the Commission may suspend and investigate rates and the burden of proof in a rate proceeding rests on the railroad.[6]

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[3] In contrast, inflationary cost increases authorized under section 206 of the Act, 49 U.S.C.A. § 10712 (West Supp. 1981), go into effect automatically unless the railroad applies for an exception.

[4] Even within the zone of rate flexibility, however, the Commission may investigate a rate increase that results in a revenue-variable cost percentage equal to or in excess of the amounts stated in 49 U.S.C.A. § 10707a(e)(2)(A).

[5] The total zone of "rate flexibility" for rate increases during the four years following passage of the Act is set at 118 percent of the adjusted base rate. *See* 49 U.S.C.A. § 10707a(c)(1) (West Supp. 1981). For the following four years, the burden of proof lies with the one challenging the rate so long as the rate increase is four percentage points or less of the adjusted base rate. *See* 49 U.S.C.A. § 10707a(d) (West Supp. 1981).

[6] *See* 49 U.S.C.A. § 10701a(b)(2)(B) (West Supp. 1981). The railroad also bears the burden of proof if its revenue-

Because the "zone of rate flexibility" applies to rate increases *above* the adjusted base rate, the magnitude of the underlying inflation adjustment is of critical concern to both shippers and railroads.[7]

B. *Adoption of the Modified AAR Index*

The Commission's search for an index that would properly measure inflationary cost increases preceded the enactment of the Staggers Act. On April 22, 1980, the Commission issued an Advance Notice of Proposed Rulemaking in *Ex Parte No. 290 (Sub. No. 2), Railroad Cost Recovery Procedures* soliciting suggestions for measuring average cost increases for railroads. The Commission explained that it wished to establish a mechanism by which railroads could recover increased costs without being subjected to the length and uncertainty of individualized rate proceedings. *See* 45 Fed. Reg. 29,103-04 (1980); Joint Appendix ("J.A.") 42-43. In response, the Commission received extensive comments from railroads, shippers, and purchasers of commodities shipped by rail. The railroads proposed that the Commission adopt the Association of American Railroad's ("AAR") index of rail costs. *See* Verified Statement of Dr. Paul O. Roberts & Dr. Brian C. Kullman, J.A. 52; Verified Statement of Dr. Harvey A. Levine, J.A. 420-24; Verified Statement of Mary Maher, J.A. 431-40. The shippers did not propose a specific cost index. They did suggest, however, that if the Commission adopted the AAR index it should adjust that index so that it would reflect cost savings from productivity gains. *See* Verified Statement of Leroy E. Peabody, Jr., J.A. 389-400.

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variable cost percentage equals or exceeds the lesser of the amounts set forth in 49 U.S.C.A. § 10707a(e)(2)(A) (West Supp. 1981).

[7] The Western Coal Traffic League ("WCTL") estimates that a 2.5 percentage point distortion in the inflation index could lead to "unwarranted rate increases" of $580,000,000 in a single year. *See* WCTL Brief 3.

The AAR index is a classic Laspeyre's price index,[8] which measures the changing cost of buying a fixed "market basket" of items purchased by the railroad industry. AAR selected items for the index's market basket on the basis of surveys of purchases by major railroads. The index includes 65 items that AAR found to be widely purchased in large quantities and whose price trends follow those of related materials. *See* Verified Statement of Mary Maher, J.A. 434. AAR updates the index's "market basket" periodically to reflect shifts in the typical railroad market basket. In the past, this updating has occurred every six to ten years. *See id.*, J.A. 441.[9]

At the heart of the shippers' criticism of the AAR index was the difference between the prices railroads pay to purchase *inputs* (such as labor and materials) and the costs they incur in producing their *output* (rail service). The shippers argued that a proper measure of railroad "costs" must account for the possibility that productivity gains allow railroads to produce more rail service with the same "market basket" of railroad inputs. By accounting for these gains, they suggested that an

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[8] A Laspeyre's price index weighs price changes according to quantities purchased during the base year. *See Ex Parte No. 290 (Sub. No. 2), Railroad Cost Recovery Procedures, Final Rules*, 364 I.C.C. 841, 855 (Apr. 3, 1981). This methodology is widely used to measure consumer prices, wholesale prices, and prices paid by industry groups. *See* UNITED STATES DEPARTMENT OF LABOR, BLS HANDBOOK OF METHODS FOR SURVEYS AND STUDIES (1976).

[9] During this rulemaking proceeding, AAR stated that it was in the process of revising the AAR index. These revisions will delete six of the sixty-five items in the current index, update the weights assigned to the items purchased by railroads and will expand the index's coverage to include items other than fuel, labor, and materials and supplies. *See* Verified Statement of Mary Maher, J.A. 441-59. This new "all inclusive" index had not been formulated at the time the ICC decided this case.

input index (such as the AAR index) could and should be converted into an "output index"—namely an index of cost per unit of output.[10]

Before the Commission completed its proceedings on inflationary rate adjustments, Congress passed the Staggers Act. Section 203 of the Act requires the Commission to develop or verify an inflationary cost index with "appropriate adjustments to reflect the changing composition of railroad costs, including the quality and mix of material and labor . . . ." 49 U.S.C.A. § 10707a(a)(2)(B) (West Supp. 1981). In accordance with this mandate, the Commission issued a new Notice of Proposed Rulemaking in *Ex Parte No. 290 (Sub No. 2)*, 45 Fed. Reg. 81,217 (Dec. 10, 1980); J.A. 587-99. In this notice, the Commission stated that it found the "most acceptable measure of inflation for [its] purposes to be the AAR input price index, as modified by the Commission." J.A. 589.[11] The Commission stated its intention to review the statistical validity of the AAR index, check for data errors,[12] and compare the index

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[10] Technically, the term "output index" is not ordinarily associated with an index of cost per unit of output. Instead, the term refers to an index of the prices a firm charges for its output. *See* UNITED STATES DEPARTMENT OF LABOR, BLS HANDBOOK OF METHODS FOR SURVEYS AND STUDIES 123 (1979). Following the usage of the parties, this opinion will use the shorthand formulation "output index" to refer to an index of cost per unit of output.

[11] The Commission proposed use of the Bureau of Labor Statistics' Producer Price Index (PPI) to measure those costs not covered in the AAR index, such as depreciation, rents and taxes. *See Ex Parte No. 290 (Sub. No. 2), Railroad Cost Recovery Procedures, Notice of Proposed Rulemaking* (Nov. 21, 1980), J.A. 591. The Commission's cost index would be a weighted average of the PPI and the AAR index.

[12] The Commission proposed to: (1) check for errors in applying the AAR methodology, such as data calculation and transcription mistakes; (2) audit the underlying data pro-

with other data sources. But the Commission rejected the suggestion that the index should be modified to reflect productivity gains. While it acknowledged the "theoretical validity" of the shippers' argument that "productivity gains tend to offset the upward pressure of input prices on overall rail costs," it concluded that several considerations counseled against adoption of such an index. J.A. 591. First, it found that there is no acceptable measure of productivity available to convert an input index into an output index. Second, it noted that competition among railroads ought to curb price increases caused by an inflated cost index. Third, the Commission expressed its concern that downward adjustments for productivity gains would act as a disincentive to productivity growth. J.A. 591-92.

Following further comments, the Commission issued a final rule adopting the modified AAR index as initially proposed. *See* 364 I.C.C. 841 (1981); J.A. 928. In the explanation accompanying this rule, the Commission reexamined its original rationale for not adjusting the AAR index to reflect productivity gains. First, the Commission conceded that methodological problems do not pose an absolute bar to developing measures of productivity; but it noted that these problems were nonetheless "grave." *See id.* at 846; J.A. 931. As to the effect of a productivity deflator on incentives for productivity growth, the Commission stated its agreement with the shippers that an adjustment reflecting *average* productivity trends would not eliminate all incentives for individual railroads to maximize their own productivity gains. *Id.* at 847-48; J.A. 931-32. But the Commission said that this argument cuts two ways. While the incentive to achieve better than average productivity gains remains, those railroads that are unable to meet the industry's average performance would be unable to recover

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vided by railroads; and (3) cross-check the AAR data for internal consistency. J.A. 589.

(through non-reviewable rate increases) the full measure of their inflation-induced increased costs. Finally, the Commission expressed its skepticism that, even if rates were set by competitive forces, productivity gains would be passed along to consumers. It reasoned that under competitive conditions, firms must retain revenues from cost savings if they are earning insufficient revenues to cover costs. Because it had elsewhere found that the rail industry typically earns inadequate revenues to cover economic costs, it concluded that it would be inappropriate to pass along productivity-related savings. *Id.* In summation, the Commission stated that "as long as the railroad industry continues to earn inadequate revenues," it would not adjust the AAR input index to reflect productivity. *Id.*

II. ANALYSIS

A. *Consistency With the Staggers Act*

The first question before us is whether the Commission properly interpreted its statutory mandate. The Commission stated:

> [T]he Rail Act does not specify whether an input cost index or an output cost index is to be used as the rail cost adjustment factor. Instead, the Rail Act leaves this matter up to the Commission, as a matter of policy, to be determined in a manner consistent with the purpose of the Rail Act as a whole.

364 I.C.C. at 846; J.A. 931. Turning to the considerations that should guide its policy determination, the Commission explained that "[in] broad terms, . . . the purpose of section 203 is to permit rail carriers to neutralize the effects of inflation through rate increases with minimum regulatory intervention." *Id.* After discussing why an input index properly serves this objective under current conditions, the Commission carefully preserved its authority to require productivity adjustments in the future, stating that "[it] will not adjust the rail cost index

to reflect productivity gains *as long as* the railroad industry continues to earn inadequate revenues." *Id.* at 847 (emphasis added); J.A. 931.

In their petitions for review, the Western Coal Traffic League ("WCTL")[13] and the Chemical Manufacturer's Association ("CMA"), joined by several intervenors,[14] argue that the Act does not leave the Commission with discretion to choose between output and input cost indices.[15] They contend that the plain meaning of section 203, its legislative history, and the overall structure of the Act *require* that the Commission develop an index that reflects productivity changes. A third view of section 203 is presented by the Association of American

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[13] WCTL's brief was also filed on behalf of petitioners in Nos. 81-1480, 81-1528, 81-1547, 81-1590, 81-1639, 81-1642, 81-1659, and 81-1661 and three intervenor-petitioners, Duke Power Company, The National Industrial Traffic League and Virginia Electric Power Company.

[14] Additional briefs were filed by intervenor-petitioners American Iron and Steel Institute and Central Illinois Light Company and by intervenor Nevada Power Company. An *amicus curiae* brief urging reversal was filed by the Consumer-Owned Power Coalition.

[15] Petitioners in Nos. 81-1437, 81-1480, 81-1590 also challenge application of the modified AAR index to rates that contain an element of excess profit. In essence these petitioners would require review of the reasonableness of rates prior to application of the cost adjustment index, even after the 180 day period for challenging rates has expired. The Staggers Act, however, clearly provides that the cost adjustment index may be applied to *any* market dominant rate that was not challenged within that time period or that withstood such a challenge. *See* 49 U.S.C.A. § 10707a (West Supp. 1981).

In a similar effort to prevent specified rates from rising in accordance with average costs, intervenor Nevada Power Company argues that the Commission should have developed a separate cost index for coal traffic. We fail to see, however, how the statutory mandate to develop *an* index of rail costs may be read as *requiring* separate indices for each type of traffic.

Railroads ("AAR") as intervenor-respondent. AAR argues that the Commission was required to adopt an input index. AAR Brief 32. Indeed, at some points in their brief, the Commission's attorneys appear to be sliding into this third position, *see* Government's Brief 20, even though we read the Commission's decision as clearly finding room under the Act to allow for productivity adjustments to the inflationary cost index at some future time.

1. *The "Plain Meaning" Debate*

All sides of this controversy lay claim to the plain meaning of section 203. As we have often observed, the meaning of *some* statutory provisions is sufficiently clear to resolve disputes over their interpretation. *See, e.g., McCord* v. *Bailey*, 636 F.2d 606, 614-15 (D.C. Cir. 1980), *cert. denied*, 451 U.S. 983 (1981). The language of section 203, however, does not fit into that category. In particular, it does not point us towards a specific statistical methodology for calculating inflationary cost increases.

Section 203 requires that:

> Commencing with the fourth quarter of 1980, the Commission shall, as often as practicable but in no event less often than quarterly, publish a rail cost adjustment factor which shall be a fraction, the numerator of which is the latest published *Index of Railroad Costs (which index shall be compiled or verified by the Commission, with appropriate adjustments to reflect the changing composition of railroad costs, including the quality and mix of material and labor)*, and the denominator of which is the same index for the fourth quarter of 1980, or for the fourth quarter of 1982 or for the fourth quarter of every fifth year thereafter, as appropriate.

49 U.S.C.A. § 10707a(a)(2)(B) (West Supp. 1981) (emphasis added). CMA suggests that this language clearly indicates Congress' concern with railroad *costs*.

Thus, "the index must be adjusted to reflect *cost* changes due to changes in the mix of expenses incurred by railroads, including the use of less labor or fuel due to more efficient technology and operating methods." CMA Brief 14. In short, an adequate measure of changing *costs* must account for more efficient uses of input items through productivity gains. The Commission's attorneys, in an argument we find somewhat at odds with the Commission's articulated position, contend that the common sense meaning of section 203 requires adoption of an input index. They state that "the natural, common sense meaning of the statutory phrase 'composition of railroad costs' is the formation of a total cost by putting together the different prices paid by railroads for the goods and services they purchase." Government's Brief 19. After noting that "the prices of labor and materials mentioned in the statute are indisputably inputs," they state that: "Because none of the words in the statute embody concepts related to output, the statute cannot be read to embody productivity, which is a concept inextricably linked to output." Government's Brief 19.

We find neither interpretation of the "plain meaning" of section 203 very persuasive.[16] Turning first to the Commission counsel's argument, it is hardly self-evident that the required adjustments for "quality and mix" are not output-related. For example, gains in labor produc-

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[16] We also question the wisdom of interpreting these words without any reference to the function of the inflationary cost index within the statutory scheme of the Staggers Act. As we discuss, *infra*, this function is simply to allow railroads to receive timely rate increases to cover inflationary cost increases. The interpretation forwarded by the AAR and the Commission's attorneys, however, would allow for unreviewable, profit enhancing, rate increases. Moreover, by grounding this interpretation in the language of the statute, these parties would preclude any future attempts by the Commission to correct its index for productivity growth, even if omitting that cost factor causes significant distortions in the index.

tivity could be considered an improvement in the "quality" of labor. Similarly, the "mix" of labor and materials could refer to total quantities of inputs, and not simply the proportionate share of different types of inputs. If either of these interpretations is correct, a productivity adjustment would fall within the adjustments authorized by the Act. But a more basic problem with the Commission's argument is that it sets up an artificially neat dichotomy between "input" and "output" indices.[17] Although the two types of indices are theoretically different—with input indices measuring the cost of a "market basket" of inputs and outputs indices measuring cost per unit of output—an "output" index is still critically concerned with the cost of inputs. The main difference between the two approaches is that an output index looks at *additional* factors that affect a firm's cost per unit of output. The fact that an output index would take additional steps to determine cost per unit of output—steps that, arguably, are not specifically mentioned in section 203—does not mean that Congress meant to preclude such adjustments. Congress drafted section 203's mandate for appropriate adjustments with *inclusive*, not exclusive, language. To read it as "plainly" rejecting an index reflecting all factors bearing on cost per unit of output is unwarranted.

CMA's "plain" reading is equally faulty. CMA asserts that a true cost index must include all factors bearing on cost per unit of output, even though the AAR index stands as a stark reminder that not all such indices make the fine adjustments it recommends. Furthermore, CMA overlooks the full statutory language of section 203, which only requires "appropriate" adjustments. Since one

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[17] It is noteworthy that no party has directed our attention to an example of an "output" index. Rather than proposing an independent "output" methodology, the shippers seek to have the AAR index adjusted so that it reflects the impact of productivity changes on cost per unit of output.

critical issue in this case is whether estimates of productivity gains on a quarterly basis are feasible, CMA's contention that productivity is a cost factor, even if accepted, is insufficient to prove that a productivity adjustment is "appropriate" and, therefore, statutorily mandated.[18]

2. *Legislative History of Section 203*

a. *Redrafting of Section 203*

As further support for their respective interpretations of section 203, the parties turn to the history of its revision in committee. The original version of S. 1946, the bill that became the Staggers Act, described the inflationary cost index as an "Index of Railroad Material Prices and Wages." *See* S. 1946, 96th Cong., 2d Sess. § 103 (1980). This description clearly pointed towards an input index, if not the AAR index itself.[19] Following

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[18] We also reject petitioners' suggestion that the bare language of section 219 precludes use of an input index to determine the permissibility of general rate increases. Section 219 limits antitrust immunity for rate bureaus discussing or voting on railroad rate increases, but provides that these limitations will not apply to "general rate increases to cover inflationary cost increases" until January 1, 1984. *See* 49 U.S.C.A. § 10706(a)(3)(B) (West Supp. 1981). This provision was added in Conference, and is not accompanied by any explanatory legislative history. *See* H. REP. No. 96-1430, 96th Cong., 2d Sess. 114 (1980). Absent any indication that the term "inflationary cost" was intended to have different meanings in sections 219 and 203, we conclude that it is proper for the Commission to use a valid section 203 index to determine whether general rate increases fall within the immunity provisions of section 219.

[19] The AAR index is officially entitled an "Index of Railroad Material Prices and Wages," the same title that S. 1946 gave to its inflation index. Thus, it is hardly surprising that some witnesses before the Senate, and the parties in this case, inferred that S. 1946 was in effect proposing adoption of the AAR index. *See, e.g.*, 1 *Railroad Transportation Policy Act of 1979, Hearings Before the Senate Committee on Commerce,*

hearings on S. 1946, during which shippers advocated adoption of an output index, the bill was redrafted to refer to the inflationary cost index as an "Index of Railroad Costs [with] appropriate adjustments to reflect the quality and mix of material and labor." [20] In arguments paralleling their analysis of the "plain meaning" of section 203, petitioners, the Commission, and the railroads, seek to draw from this redrafting of section 203 (section 103 of S. 1946) unequivocal support for their conceptions of the proper index. Petitioners argue that the committee redrafted section 203 in response to the concerns of shippers, and therefore intended to reject input indices. The Commission and the railroads argue that the committee redrafted section 203 only to provide a more general description of an input index; they reason that since the committee failed to draft in any specifically output-related concepts, its actions should be read as a rejection of output indices. Frankly, we find it difficult to agree with either of these rigid theories of what the Senate Committee revisions meant. What little can be discerned from the redrafting of section 203 indicates to us only that the committee sought to replace specific language pointing towards an input index with a more general mandate to the Commission to select an index with "appropriate" adjustments. Whether adjustments serving to convert an input index into an output index are authorized or required must therefore depend largely on whether they serve the underlying purposes of the statutorily mandated index.

Science, and Transportation on S. 1946 428 (1979) (*"Senate Hearings"*) (Statement of Ellis Cox); *id.* at 435 (Statement of Gerald W. Fauth, Jr.). S. 1946, however, clearly contemplated the possibility that the Commission would adopt another index since it specified that the index could be "compiled" by the Commission.

[20] *See* S. REP. No. 96-470, 96th Cong., 1st Sess. 52 (1979) ("S. REP.").

Section 203 attracted considerable attention during hearings on S. 1946. Numerous witnesses appearing before the Senate Committee on Commerce, Science, and Transportation argued that language describing an input index was inappropriate if the *purpose* of indexing base rates was simply to neutralize the effect of cost increases on railroad profits. These witnesses explained that the bill's formula was "not flexible enough to recognize that certain carriers may come up with innovation, that change in volume, that change in traffic mix should be considered in the automatic adjustment." *See* 1 *Railroad Transportation Policy Act of 1979: Hearings on S. 1946 Before the Committee on Commerce, Science and Transportation of the United States Senate*, 96th Cong., 1st Sess. 395 (*"Senate Hearings"*) (statement of Edwin Wheeler).

These criticisms were repeated throughout the Senate hearings,[21] with one witness proposing that section 203 be redrafted to specifically require that "[the] rail cost adjustment factor . . . be adjusted to reflect changes in the productivity of labor, and changes in the volume and mix of traffic." *See id.* at 399 (statement of Edwin Wheeler). Finally, on the last day of the hearings, Senator Cannon discussed changes in the language of section 203 with Edmund B. Frost, vice-president and general counsel of CMA:

> Senator CANNON: With regard to section [203], you note that the formula set forth in S. 1946 doesn't specifically require consideration of such factors as changes in traffic volume and labor productivity, although it does call for commission compilation or verification of any index.

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[21] *See, e.g., Senate Hearings* 428 (Statement of Ellis Cox); *id.* at 435 (Statement of Gerald W. Fauth, Jr.); *id.* at 587 (Statement of L. T. Barringer); *id.* at 631 (Statement of PPG Industries); *id.* at 667 (Statement of the National Broiler Council).

> Several witnesses have suggested that in compiling the index, specific consideration be given to changes in volume, productivity, and traffic mix.
>
> I assume language along those lines, if adopted, would satisfy your concerns on that point.
>
> Mr. FROST. I think it might very well satisfy my concerns.

As redrafted by the committee, however, section 203 did not "specifically require consideration of such factors as changes in traffic volume and labor productivity." Instead, it provided the Commission with a general mandate to make "appropriate adjustments to reflect the quality and mix of material and labor." This language was modified once more in conference to require "appropriate adjustments to reflect the composition of costs, including the quality and mix of material and labor." [22] Neither change in the language of section 203 was explained in the accompanying committee reports.[23]

Courts must exercise caution before drawing inferences regarding legislative intent from changes made in committee without explanation. *See Trailmobile Co.* v. *Whirls*, 331 U.S. 40, 61 (1947). Although a succession of draft bills may point toward a clear legislative purpose, *see* J. HURST, DEALING WITH STATUTES 42-43 (1982), amendments to a bill's language are frequently latent with ambiguity: they may either evidence a substantive change in legislative design or simply a better

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[22] The House bill contained a provision for inflation increases, but did not provide any description of an inflation index. The Conference Committee adopted the Senate's proposal for computing an adjusted base rate on the basis of a rail cost adjustment factor. *See* H. REP. No. 96-1430, 96th Cong., 2d Sess. 93 (1980) (Conference Report).

[23] Indeed, despite changes in the language of section 203, the Senate Report provided the very same description of the index as Senator Cannon had when he introduced S. 1946. *Compare* S. REP. at 19-20 *with* 125 CONG. REC. S 15315 (daily ed. Oct. 29, 1979).

means for expressing a provision in the original bill. *See* C. SANDS, SUTHERLAND STATUTORY CONSTRUCTION § 48.18 (1973).

In this case, the legislative record supports an inference that the committee redrafted section 203 in response to the shippers' testimony, but it collapses as a foundation for understanding *how* the committee chose to resolve the conceptual and methodological problems of cost indexing. It is possible that the committee sought to accommodate the shippers' concerns, viewing language on the quality and mix of labor and materials as a general formulation of the kind of adjustments needed to make an input index accurately reflect costs per unit of output. Alternatively, the committee may have sought to reaffirm the approach of the original bill, requiring only those refining adjustments that fit easily within an input methodology. Neither the committee's rejection of the bill's original language, nor its rejection of the shippers' proposed amendment provides a reliable basis for choosing between these two readings. We must therefore search for such guidance in an examination of the purposes and placement of section 203 in the overall statutory scheme.

b. *Underlying Purpose of Section 203*

The shippers ground their argument that section 203 mandates an output index on the purpose of the inflationary cost index. They contend that the underlying purpose of the inflationary cost index is to enable railroads to recover costs; no more and no less. Thus, they conclude, section 203 requires an output index, or at least an input index modified to approximate an output index. Otherwise, the index will authorize market dominant railroads to overrecover costs during periods of productivity growth at the expense of captive shippers.

We agree with the shippers that the principal function of the section 203 inflationary cost index is to provide a

mechanism for recovering inflation-based costs, not to enhance revenues. But the legislative history of section 203 also demonstrates that Congress sought a cost-recovery mechanism that would avoid regulatory lag by operating with dispatch to assure that rates actually reflect current costs. Insofar as any particular methodology would interfere with achievement of this practical objective, its adoption cannot be characterized as mandated by the Act.

In introducing S. 1946, Senator Cannon explained that the bill's overall approach was "to provide the railroads with more pricing flexibility while protecting captive shippers" and to "streamlin[e] the administrative process so as "to simplify rather than further complicate railroad regulation." 125 CONG. REC. S 15309 (daily ed. Oct. 29, 1979). To accomplish these purposes, S. 1946 set up a simple test for determining whether a rate is subject to Commission review, and specified percentages by which railroads could increase rates without facing any threat of rate suspension. The bill, like the Act itself, set forth a two-part test for judging rate increases.[24] Rate increases to recover costs would be free from attack while additional rate increases up to a specified percentage could not be suspended and could only be challenged by shippers who would bear the burden of proving unreasonableness. Discussing the first threshold—the percentage increase authorized by the inflationary cost index—Senator Cannon explained:

> The railroad's financial difficulties may be attributed in part to the timelag involved in recovering cost increases. *This section will assure that rail rates reflect a carrier's current costs.*

125 CONG. REC. S 15315 (daily ed. Oct. 29, 1979) (emphasis added). In contrast, he stated that the bill's "rate flexibility zone above cost increases" within which ship-

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[24] *See* pp. 7-9 *supra*.

pers bear the burden of proving unreasonableness would "assist the railroads in achieving adequate revenue levels and [would] provide additional flexibility for rate changes without regulatory interference." *Id.*

Throughout hearings on S. 1946, witnesses adhered to the view that the function of the inflationary cost index was to allow railroads to receive rate increases warranted by cost increases without the expense and delay of rate review proceedings. *See, e.g., Senate Hearings* 122-23 (Statement of A. Daniel O'Neal); 444 (Statement of Richard E. Miller); *id.* at 541 (Statement of Bruce A. Melaas). Indeed, the bill's limitation of its "free zone" to cost-based increases stood in stark contrast to the administration's proposed bill—which would have allowed for annual seven percentage point rate increases above cost increases. *See Senate Hearings* 136-37 (Statement of William H. Dempsey).

Although witnesses at the Senate hearings proposed changes in the bill's language to assure that the index would accurately reflect incurred costs or to explicitly allow free rate increases above costs,[23] no one suggested that the function of the inflationary cost index was anything other than to provide a rapid mechanism for translating cost increases into rate increases. This view of the underlying purpose of the inflation index was reaffirmed when S. 1946 was reported out of committee. *See* S. REP. NO. 96-470, 96th Cong., 1st Sess. 19-20 (1979); 126 CONG. REC. S 3278, S 3280 (daily ed. Apr. 1, 1980) (Statement of Senator Cannon).[24]

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[23] *See, e.g., Senate Hearings* 136-37 (Statement of William H. Dempsey) (proposing a "free zone" for rate increases above the bill's "zone of rail cost inflation").

[24] Although the Conference Committee did not explain its reasons for redrafting section 203 to require appropriate adjustments to reflect the "composition of railroad costs, *including* the quality and mix of material and labor" (emphasis added), this broadening of section 203's language reinforces

This consistent view of the function of the inflationary cost index, however, falls short of proving that section 203 envisions an output index. As the Commission noted, the theoretical validity of increasing rates in accordance with costs per unit of output is a different matter from the soundness of insisting that whatever "output" methodology is currently available be immediately incorporated into the cost index regardless of its reliability. If that methodology is unreliable, or involves undue delays, the resulting index could hamper rather than help the statutory goal of timely rate increases to cover current rail costs. Congress may well have had in mind the difficulties of translating statistical theory into practice when it required the Commission to make only "appropriate" adjustments to its cost index. Thus, while we agree with petitioners that the *purpose* of section 203 was to allow railroads to keep up with cost increases, we cannot conclude that this purpose mandates adoption of an output index regardless of the accuracy of such an index or the feasibility of designing it so as to allow railroads to obtain rate increases in a timely manner.

B. *Application of Section 203*

Petitioners argue that even if section 203 does not mandate adoption of an output index, the Commission acted arbitrarily and capriciously by not adjusting the AAR index to reflect productivity growth.[27] They assert

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the view that the index was intended to allow for all factors bearing on railroad costs.

[27] CMA also argues that the Commission failed to verify the modified AAR index and failed to provide interested parties with an opportunity to review the data underlying that index. CMA Brief 26-28. Both these contentions misperceive the purpose of the rulemaking in this case. That purpose was to select a general *methodology* for measuring the impact of inflation on railroad costs, not to actually *measure* rail cost inflation. The Commission's "verification" obligation at this initial stage was to assure that the index

that the Commission, relying on inappropriate considerations, engaged in an unexplained departure from its settled practice of considering productivity data in ratemaking proceedings. We disagree. In developing its cost index the Commission faced a new task: how to estimate, on an average and current basis, the impact of inflation on railroad costs. In formulating an answer to that question, the Commission squarely addressed the propriety of a productivity adjustment. Although we find some weaknesses in the Commission's reasons for rejecting a productivity adjustment, we conclude that the Commission did provide a sufficiently adequate explanation for not including such an adjustment *at this time*. We would emphasize, however, that the Commission's reasoning is barely adequate, and that we firmly anticipate that its experience with the modified AAR index will shed further light on the soundness of its chosen course, and may well affect its discretion to continue to omit any productivity adjustment in the future.

1. *Scope of Review*

When an agency rule is challenged as arbitrary and capricious, the scope of judicial review is narrow. Courts may not substitute their judgment for that of the agency, *see Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402, 416 (1971); *Ethyl Corp.* v. *EPA*, 541 F.2d 1, 34 (D.C. Cir.) (*en banc*), *cert. denied*, 426 U.S. 941 (1976). Nor may they require agencies to follow procedures not

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did not contain unreasonable biases. The Commission fulfilled this obligation by reviewing the AAR index's methodology and making appropriate adjustments to reflect the composition of railroad costs. *See* 364 I.C.C. at 843-44; J.A. 929. Similarly, since the purpose of the rulemaking was to choose a methodology, it was sufficient to provide interested parties with a detailed description of the AAR index, its underlying assumptions, and the methods by which it is constructed. *See Notice of Proposed Rulemaking*, 45 Fed. Reg. 81220-36; J.A. 605-19. *See also* Verified Statement of Mary Maher, J.A. 429.

required by statute. *See Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519, 548 (1978). But in reviewing rules promulgated under the notice and comment rulemaking requirements of the Administrative Procedure Act, 5 U.S.C. § 553 ("APA"), courts must assure that the agency has provided a reasoned explanation for its rule. In particular, a reasoned explanation for agency action must be based on a consideration of relevant factors, *see Citizens to Preserve Overton Park, Inc.* v. *Volpe*, 401 U.S. at 416, providing reasons that do not contravene "ascertainable legislative intent." *See Environmental Defense Fund* v. *Costle*, 657 F.2d 275, 283 (D.C. Cir. 1981). Furthermore, an agency decision may not be reasoned if the agency ignores vital comments regarding relevant factors, rather than providing an adequate rebuttal. *See Alabama Power Co.* v. *Costle*, 636 F.2d 323, 384-85 (D.C. Cir. 1979); *PPG Industries, Inc.* v. *Costle*, 630 F.2d 462, 467 (6th Cir. 1980). Within these bounds of reasoned decisionmaking, agencies possess a wide measure of discretion, allowing them the flexibility to adapt to changing circumstances and to reevaluate past policies. *See American Public Gas Association* v. *FPC*, 567 F.2d 1016, 1059 (D.C. Cir. 1977).

In this case, the narrowness of our scope of review is reinforced by the narrowness of the Commission's action. Although the Commission adopted a methodology for indexing rail costs that does not include a specific productivity adjustment, it stated its intention to periodically check the results of its current methodology against other data sources, including its own cost data. *See* 364 I.C.C. at 843; J.A. 929. Furthermore, the Commission expressed its willingness to consider altering its methodology to include a specific productivity adjustment at some later date. *See id.* at 847; J.A. 931. Therefore, the issue before us is simply whether the Commission has adequately supported its decision to omit such an adjustment *at this time*.

2. *Adequacy of the Commission's Decision*

Despite the narrowness of the issue and the scope of review in this case, we find the Commission's decision is only minimally adequate. The Commission has not responded to some important comments and has relied, in part, on inappropriate considerations. Nonetheless, it has sketched out a sufficient justification to omit a productivity adjustment from its initial cost indexing methodology.

The crux of the Commission's rationale is that available productivity measures are sufficiently unreliable, and the consequences of overestimating productivity growth are sufficiently grave, that it is inappropriate to adjust the cost index on the assumption of continued productivity growth. The Commission's assessment of the unreliability of productivity measures finds support in the record. Although one witness baldly stated that a productivity adjustment is simply "an exercise in applied econometrics," *see* Verified Statement of Dr. George H. Borts, J.A. 566, the record before the Commission indicated that estimates of productivity growth are hardly a simple exercise. Some estimates are not proper measures of the impact of productivity growth on overall costs because they look at a single input. For example, the Bureau of Labor Statistics' output per manhour index fails to account for inputs other than labor. *See* Reply Verified Statement of Dr. Harvey A. Levine, J.A. 511. Efforts to estimate total factor productivity (output per unit of input), however, post significant methodological problems. The critical difficulty facing these studies is establishing a proper measure of railroad output. Witnesses explained that the conventional measure of railroad output—the "ton-mile"—produces distorted estimates of productivity trends. Under the ton-mile measure, one ton carried over ten miles and ten tons carried over one mile are treated as the same amount of railroad output. When the mix of rail traffic shifts to heavier items, like coal, "ton-miles" may increase independent of changes in

railroad productivity. *See id.*; J.A. 508, 513. Such a shift may represent no net increase in railroad revenues; indeed, if railroads charge low rates for heavier commodities, increased "ton-miles" may even represent a decline in revenues. *See id.*; J.A. 508. In these circumstances, a downward adjustment in the cost index would be inappropriate.

The difficulties of accurately estimating productivity growth are also reflected in the diverse results of past studies. One study, by Dr. John W. Kendrick, found productivity growth to be as high as 5.2 percent per year. *See id.* (*citing* J. W. KENDRICK, POST WAR PRODUCTIVITY TRENDS IN THE UNITED STATES, 1948-1969, 78-79 (1973)), J.A. 512. Another study estimated that average productivity growth was low as 0.8 to 1.8 percent per year. *See id.* (*citing* COUNCIL ON ECONOMIC ADVISERS & NATIONAL COMMISSION ON PRODUCTIVITY, TASK FORCE ON RAILROAD PRODUCTIVITY, IMPROVING RAILROAD PRODUCTIVITY 78 (1973)), J.A. 512. But even if the Commission could reconcile the expertise in estimating past productivity growth, it is by no means clear that it could develop a satisfactory mechanism for evaluating current productivity trends. This "exercise in applied econometrics" may yield a formula too low in predictive value to be reliable. Furthermore, it may be considerably more difficult to gather the relevant productivity data on a current basis than it is to price items in a market basket. Reliable current estimates, however, are of central importance to section 203's function of allowing railroads to recover costs promptly. Were the Commission to simply follow the shippers' suggestions and assume that future productivity trends will match past experience, it could over-deflate the cost index, thereby denying railroads the timely and unencumbered rate increases they deserve.[28]

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[28] Several shipper witnesses argued that even if productivity is hard to measure, the Commission should make some adjustment for productivity growth. This view is well summarized

These methodological problems take on greater importance in the light of the Commission's short statutory deadline for developing a cost index[29] and the generally

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by the Verified Statement of Thomas D. Crowley, submitted by the Western Coal Traffic League:

> [W]hile there is no general agreement on precisely what figure represents the long-term change in railroad productivity, it is understood that the proper figure is not zero. Yet, zero is the figure the Commission has in effect adopted. Even an annual change in productivity growth of 1.7 percent, the result reached in one of the studies lauded by the railroads in this proceeding (see Dr. Levine, *supra*, p. 11), would be better than the figure of zero used by the Commission.
>
> It should be understood that the 1.7 percent figure, while low, would not be insignificant if used as the basis for an adjustment to the AAR Index. This productivity adjustment (1.7 percent) reflects the percentage of *overall* costs saved by the productivity increases. In other words, if the annual change in the AAR Index equals 6.8 percent, the 1.7 percent increase in productivity would be subtracted from this annual increase resulting in a *25 percent* discount in the AAR Index.

Record 135.

This argument, though plausible at first glance, is nonetheless deceptive. Although the comments before the Commission indicated that average long-term productivity growth is greater than zero, there is no support for the conclusion that productivity is bound to grow in any one year. Indeed, the record indicates that as a result of business cycle effects, productivity may temporarily remain at a standstill, or even decline. *See* Verified Statement of Dr. Paul O. Roberts & Dr. Brian C. Kullman, J.A. 23-25. Thus the record does not support the shippers' assertion that productivity will always grow at some minimum rate.

[29] The Staggers Act required the Commission to publish a rail cost index by the fourth quarter of 1980, and to update the index on at least a quarterly basis. *See* 49 U.S.C. § 10707a (a) (2) (B). In his concurrence to the Commission's clarification of its decision in *Ex Parte No. 290 (Sub. No. 2)*, Chairman Taylor suggested that this time schedule necessitated adoption of the modified AAR index "for reasons of expediency." 365 I.C.C. 302, 303 (1981); J.A. 947.

inadequate state of rail revenues. In times of inadequate rail revenues, erroneous assumptions about efficiency gains pose a more serious threat to the solvency of railroads. As the Commission noted in its Notice of Proposed Rulemaking, crude measures of productivity growth, such as the Bureau of Labor Statistics' output per manhour series, "tend to be distorted by short run cyclical factors." 45 Fed. Reg. 81218; J.A. 601. Similarly, a simple assumption that productivity growth will follow average trends, ignores the impact of the business cycle on a railroad's ability to reduce its costs through efficiency measures. *See* Verified Statement of Dr. Paul O. Roberts & Dr. Brian C. Kullman, J.A. 69. Rather than adopt one of these measures and risk the possibility of overdeflating the cost index at times when railroads are also suffering adverse effects of the business cycle, the Commission opted for an index that provides a greater assurance of cost recovery. So long as the Commission follows through on its stated intention to review the index against current cost data, taking appropriate action in the event of overrecovery, we cannot say that its decision to err on the side of assuring cost recovery is arbitrary.

3. *The Commission's Remaining Justification*

More troubling are the Commission's remaining policy justifications for omitting a productivity adjustment. These policy arguments suggest that the Commission may be taking the position that a productivity adjustment would never be appropriate, or at least would never be appropriate during periods of revenue inadequacy.[30] If

[30] As we explained *supra*, the narrow question before us is whether the Commission adequately justified its decision to omit a productivity adjustment at this time. Having answered this question affirmatively, and recognizing the Commission's willingness to review the results of its methodology in the future, we give the Commission the benefit of the doubt that it would reevaluate the sweeping implications of its additional policy justifications in the light of its experience.

it were so, our doubts as to the Commission's rationale would be multiplied. We reiterate that in the event that the Commission's experience with the modified AAR index indicates that it provides significantly distorted estimates of railroad costs, the Commission would have to provide a more adequate explanation of its rationale for ignoring the impact of productivity on railroad costs.

a. *Penalties for Inefficiency*

The Commission's decision suggests that the effect of a productivity adjustment on railroads with below average productivity performance justifies omitting productivity as a factor in its cost index. The Commission explained that a productivity adjustment would reduce the ability of railroads to recoup their costs even if their below average performance is beyond their control. As a hypothetical example, the Commission posed the case of a productivity breakthrough for bulk commodities. It noted that "such a breakthrough would improve industry average statistics, but would be of little benefit to railroads whose traffic was predominantly nonbulk in nature." 364 I.C.C. at 847; J.A. 931.

Petitioners argue that the fallout of any statistical average on individual carriers is not a proper concern in developing an index. While we see no need to decide whether the Commission could ever bias its index in favor of those railroads that experience above average costs, we think it noteworthy that the Commission has elsewhere rejected such a biased methodology. In particular, the Commission rejected a proposal by the railroads that would have allowed railroads to increase their rates by either the national index or a regional index. Its ground for rejecting that proposal was precisely the ground urged by petitioners in this case: that such an approach "would permit the actual national average level of rates to increase more rapidly than the national average of costs." 364 I.C.C. at 852; J.A. 934. Should the

Commission adhere to its "penalty" analysis, we would expect it to explain why productivity should not be averaged, while disparate regional prices are averaged into the same index.

b. *Revenue Adequacy*

A familiar principle of rate regulation is that regulated rates should approximate rates under competitive conditions. *See* A. KAHN, 1 THE ECONOMICS OF REGULATION 65 (1970). Relying on this principle, shippers argued that under competitive conditions, productivity gains would be passed along to consumers. *See, e.g.*, Verified Statement of Leroy E. Peabody, J.A. 820-21. The Commission rejected this justification for a productivity adjustment, reasoning that productivity gains are not passed along to consumers under competitive conditions when a firm's revenues fail to cover its costs. *See* 364 I.C.C. at 847; J.A. 931. Since the Commission had previously found in revenue adequacy proceedings that railroads were receiving inadequate revenues, it concluded that productivity savings should not be passed along to shippers. *See id.*

We agree with petitioners that revenue adequacy is not a proper justification for omitting a productivity adjustment. The Staggers Act provides a twofold process for assuring revenue adequacy: an inflationary cost index and a rate flexibility zone for rate increases above costs. Under this two part structure, the purpose of the inflationary cost index is simply to allow railroads to raise their rates to reflect current costs. *See* pp. 16-20 *supra*. While the statute does not *prohibit* adoption of an index that incidentally boosts a railroad's net revenues, increasing net revenues is not a proper *reason* for refusing to make otherwise appropriate adjustments. Nonetheless, as we have observed, the inadequate state of rail revenues does provide the Commission with grounds for caution in the light of the unreliability of

productivity measurements. Thus, while we disagree with the Commission that inadequate revenues provide an independent reason for not adjusting the index, we do concede that the Commission properly concluded that an imprecise adjustment would pose greater risks in times of revenue inadequacy.

c. *Incentives for Productivity Growth*

We also fail to find a reasoned basis for the Commission's assumption that an average productivity adjustment would undermine incentives for productivity growth. Although the Commission retreated from its original statement that a productivity adjustment would *eliminate* such incentives, it has continued to assert that a productivity adjustment would have an adverse effect on incentives for productivity growth.[21] In adhering to this position, the Commission has failed to provide any supporting analysis, or answer cogent arguments made by the shippers' witnesses. These witnesses argued that an *average* adjustment for productivity growth should not affect the incentives facing any *individual* railroad.[22]

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[21] Petitioners contend that the Commission abandoned this rationale. *See* WCTL's Reply Brief 16. We disagree. In its Notice of Proposed Rulemaking, the Commission stated its view that a productivity adjustment would undermine incentives for productivity growth. The statement of reasons accompanying the rule backed off from this view, concluding that "an adjustment based on average productivity gains would *not entirely eliminate* incentives to railroads with better than average performance." 364 I.C.C. at 847 (emphasis added); J.A. 931. The clear implication of the Commission's choice of language is that productivity adjustment would have *some* adverse effect on incentives for productivity growth. This reading is shared by the Commission's attorneys. *See* Government's Brief 39.

[22] The shippers' witnesses argued that even railroads with below average performance will have an incentive to improve their own productivity so as to avoid the "penalty" of a rate adjustment below that required to cover costs. *See, e.g.*,

They suggested that if automatic rate increases were adjusted for average productivity growth, individual railroads would have an incentive to recoup gains from above average performance or to avoid the "penalty" effects of below average performance. While we recognize that the science of quantifying economic incentives is far from exact, we would expect the Commission to provide some indication of its answer to these significant comments. Otherwise, the Commission's bald assertion that a productivity adjustment would adversely affect incentives for productivity growth is an inadequate basis for ignoring potentially significant element of railroad costs.

III. Conclusion

In affirming the Commission's order, we share some of the doubts expressed by ICC Chairman Taylor that the modified AAR index may not be precisely the type of index envisioned by the statute. *See Ex Parte No. 290 (Sub. No. 2), Railroad Cost Recovery Procedures, Clarification of Decision*, 365 I.C.C. 302, 303 (1981) (Chairman Taylor, concurring); J.A. 947. Our role on review, however, is limited to determining whether the Commission has reasonably interpreted its statutory mandate and adequately justified its choice of index. We conclude that within the present state of the art—at least as reflected in this record—the difficulties of accurately measuring productivity growth on a current basis, coupled with the Commission's assessment of the impor-

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Verified Statement of Carl M. Snavely, Jr., J.A. 709 ("there is as much, if not more, incentive to avoid a penalty than there is to achieve a gain"); Verified Statement of Dr. George H. Borts, J.A. 567 ("It is only on captive traffic that the railroads have a guaranteed market. But even here they would have to raise productivity to remain whole."); Verified Statement of Jeffrey C. Kline, J.A. 639 ("using regional or national average costs, each carrier would maximize its profits by striving to increase its productivity more than the average level").

tance of assuring railroads unencumbered rate increases to cover increased costs, support the Commission's conclusion that a productivity adjustment is inappropriate under present circumstances. We expect, however, that in accordance with its stated intentions, the Commission will continuously review the accuracy of its chosen index and will revise the index in an appropriate fashion, including consideration of measurable productivity gains, as the circumstances warrant.

IN THE
United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

United States Court of Appeals
for the District of Columbia Circuit
FILED JUN 15, 1982
GEORGE A. FISHER
CLERK

No. 81-1437

Western Coal Traffic League, *Petitioner,*

v.

United States of America and
Interstate Commerce Commission, *Respondents*

. . . . . .

Association of American Railroads, et al., Intervenors

. . . . . .

And consolidated cases

BEFORE: Wald, Mikva and Ginsburg, Circuit Judges

ORDER

On consideration of petitioner's petition for rehearing and for leave to file supplemental appendix, it is

ORDERED by the Court that leave to file a supplemental appendix is denied, and, it is

FURTHER ORDERED By The Court that the petition for rehearing is denied.

Per Curiam

FOR THE COURT:

George A. Fisher,
Clerk

BY: Robert A. Bonner
Chief Deputy Clerk

September Term, 1981

ARGUED 2-2-82

Served April 17, 1981

31307

INTERSTATE COMMERCE COMMISSION

EX PARTE NO. 290 (SUB-NO. 2)

RAILROAD COST RECOVERY PROCEDURES
(49 CFR 1102)

Decided April 8, 1981

AGENCY: Interstate Commerce Commission.
ACTION: Final rules.
SUMMARY: The Commission adopts a cost recovery index in accordance with the requirements of section 203 of the Staggers Rail Act of 1980. This index revises existing rules and procedures for the filing of general rate increases by railroads. These rules are intended to simplify and expedite recovery of cost increases through the use of a zone of reasonableness, the top of which is based on an index of railroad costs.
EFFECTIVE DATE: 30 days from publication in the Federal Register.
FOR FURTHER INFORMATION CONTACT:

Richard Felder (202) 275-7656
or
Barry Harris (202) 275-0810

SUPPLEMENTARY INFORMATION:

BACKGROUND

By advance notice of proposed rulemaking served April 28, 1980 (45 F.R. 29103, May 1, 1980), we indicated our intention to revise procedures for filing railroad general rate increases by an inflation index. This was followed by a notice of proposed rulemaking issued November 21, 1980 (45 FR 81217, December 10, 1980). In the interim, the Staggers Rail Act of 1980 (Rail Act) became law, giving the Commission new statutory duties and authority with respect to adjusting rail rates to reflect inflation. Three sections of the Rail Act affect Commission authority in the rail general increase area. Section 203 of the Rail Act provides that the Commission shall publish a "rail cost adjustment factor," at least quarterly, as a basis for a zone of rail rate flexibility for individual carrier rate changes. Section 206 of the Rail Act provides that the Commission

may prescribe a percentage rate increase or rate index for rail carriers in order to compensate for cost increases caused by inflation. Increases permitted under section 206 would go into effect automatically unless carriers notify the Commission that they wish to exclude all or part of their rates from the increase. Any increases taken under section 206 would limit the increases available under section 203. Finally, section 219(f) of the Rail Act provides that the Commission may not take any action to eliminate general rate increases before April 1, 1982.

In this proceeding, we are implementing the requirements of section 203. Section 203 reads, in part, as follows:

> Commencing with the fourth quarter of 1980, the Commission shall, as often as practicable but in no event less often than quarterly, publish a rail cost adjustment factor which shall be a fraction, the numerator of which is the latest published Index of Railroad Costs (which index shall be compiled or verified by the Commission, with appropriate adjustments to reflect the changing composition of railroad costs, including the quality and mix of material and labor), and the denominator of which is the same index for the fourth quarter of 1980 * * *.

In addition, we have concluded that the section 203 index should be used as a basis for collective rate increases as well as independent carrier actions. For this reason we are replacing our existing rules governing rail general increases (49 CFR 1102) with the rules discussed here. We think this is appropriate given that the index required by section 203 is calculated on the basis of industrywide, rather than individual carrier cost increases.

As indicated in the notice, we have also decided, particularly in light of the discretionary nature of section 206 of the Rail Act, not to implement it at this time. Given the permissive language of section 206, it is clear that Congress did not intend it to be the exclusive means of implementing general increases. Section 206 requires that all rail rates be raised to the index level, unless a carrier notified the Commission that it wishes to exclude one or more of its rates. Since all parties to a joint rate must join in such a notice of exclusion, section 206 is a less efficient means of cost recoupment than the section 203.

Choice of an index.—As proposed in the notice, the Commission finds the most acceptable measure of changes in rail costs for our purposes to be the input price index compiled by the Association of American Railroads (AAR), as modified by the Commission. These modifications include the augmentation of the AAR index with an index that measures changes in the cost of durable assets.

The modified index will be used until the AAR's all-inclusive index is ready (as we anticipate it will be by mid-1981). When the new AAR index is available for analysis we will then determine if it should be

employed, or whether an index developed by the Commission should be substituted. The modified AAR index is set forth in appendix A. It is designed to measure the impact of inflation on the labor, material, and service inputs required by railroads, and is available on a timely basis. The Commission will verify and closely monitor its effectiveness to ensure that inflation in rail cost is accurately measured.

Specifically, we will assist in the development of audit and investigative systems for future index calculations that will:

1. Determine that the methodology used by the AAR is mathematically and statistically sound and consistent from year to year.
2. Check for errors in application of the methodology including errors of calculations and transcription.
3. Audit underlying data at the railroad level to verify the factual integrity of the index at the data source. This step will include an investigation of data outliers and various cross-checks for internal consistency in the data.
4. Compare the AAR index with other data sources such as Bureau of Labor Statistics data and Commission cost data.

The initial analysis of the AAR index by the Commission has not disclosed any systematic bias that would make its use inappropriate in this initial determination, except that it does not reflect the current mix of input factors. We will remedy this deficiency by updating the weighting of each category of cost included in the AAR index. Categories of costs in the AAR index are currently weighted in proportion to their relative portion of total costs as reported by all class I railroads in 1974. We shall apply instead the proportion each category represents of total costs as reported by all class I railroads in their Annual Reports R-1 for 1979. We will work with the AAR during the next several months to improve further the index and ensure equitable treatment of all component costs.

Many participants in this proceeding have opposed the use of the AAR index on the grounds that it is a "price" index as opposed to a "cost" index and is, therefore, incompatible with the intent of Congress as expressed in Section 203 of the Rail Act. Since a price index reflects inflationary increases in rail input prices, while a cost index reflects inflationary increases in cost per unit of rail service, the two are not always equivalent. This issue is closely related to the "productivity adjustment" issue addressed by many participants, and will be dealt with later in this decision.

Another objection to use of the AAR index raised by some of the participants (*e.g.*, the National Industrial Traffic League) is that it is improper for the Commission to use an inflation index developed by the beneficiaries of that index—that is, the railroads themselves. The Commission does not believe this to be a valid criticism for the following reasons:

1. The AAR index is the only index that specifically reflects inflationary increases in rail costs and that is available to the Commission within the short time period allotted.

2. The Commission and others have often used the AAR index, or components of it, in the past, generally without challenge. (For example, the carload cost scales published by the Commission and often cited by shippers in rate cases, and escalator clauses, based on the AAR index and incorporated in at least two dozen rail/shipper contracts in the last year.)

3. As indicated above, the Commission will carefully monitor the index and correct any errors that may be found.

Since certain inflation-related increases in costs are not currently reflected in the AAR index (i.e., the cost of durable assets), we suggested in the notice of proposed rulemaking that the Producer Price Index (PPI) be used on an interim basis to measure these excluded items.

A number of participants have critized the proposed use of the PPI for this purpose. The U.S. Department of Transportation (DOT), for example, proposed that we assume inflation to affect items not covered by the AAR index the same way it affects those items currently covered. We note, however, that the existing AAR index may overstate increases in capital costs due to the weight given to rapidly escalating fuel costs and reject the DOT proposal for that reason.

On the other hand, several participants (for example the Western Coal Traffic League (WCTL) and other coal interests, the Edison Electric Institute and the Chemical Manufacturers Association) also believe the PPI, overstates inflationary cost increases in the items not covered by the AAR index, but offer no feasible alternative treatment of those items not covered by the AAR index. Not to adjust those items for inflation at all would be to assume that they experience no cost increases as a result of inflation, which would clearly be unrealistic.

We again stress that the PPI will be used on an interim basis only. When the all-inclusive AAR index becomes available, we will use that in preference to the PPI. Alternatively, we are considering substituting a composite rail asset index developed by the Commission for measuring cost changes in durable asset accounts if implementation of the all-inclusive AAR index is not feasible in a reasonable time period. This proposed Commission index is described in the next section of this decision. We expect to invite comments on its merits as a substitute for the all-inclusive index.

The table below illustrates the application of the modified AAR and PPI index for the year 1979. The weighting factors reflect the proportion of total costs attributable to each category of inputs, reported by class I railroads in their 1979 Annual Reports R-1.

Composite AAR and PPI index (1967 unit index = 100)

Category	1979 Unit index (I)	1979 Weighting factor (W)	W x I
Salaries, wages and supplements	303.8	0.531	161.3
Fuel	606.4	0.101	61.2
Other material and supplies	252.5	0.133	33.6
Purchased service	[1]235.6	0.142	33.5
General	[1]235.6	0.060	14.1
Passenger	[1]235.6	0.033	7.8
			311.5

[1]Using PPI, annual average, all commodities.

ICC composite index.—The ICC composite index mentioned above is a continuation of an index series for durable asset accounts that was published by the Commission prior to 1967. Values of the index from 1967 have been updated through the application of other well-known indexes on a primary and investment account basis that have been reported continuously during this period. These accounts are described in appendix B. The selection of such an index series was based upon matching each selected index to the class of assets contained in the primary account. Each account index is weighted by the proportion of investment in that account to arrive at a calculated composite index for all durable accounts. Because accurate data are not available, this composite index excludes the land account.

After further consideration, we now believe the ICC composite index may better measure changes in rail asset costs than the PPI because: (1) the indixes used to construct it are being used in other Commission proceedings, thereby providing consistency; (2) the indixes were developed in consideration of railroad properties only, thereby providing uniformity of application; and (3) it uses the index components that are specifically matched to the contents of the primary account.

In addition to those costs directly covered by the ICC composite index, there are certain residual costs that ideally should be reflected in the rail cost adjustment factor. The Commission proposes that such costs be developed and factored into the rail cost adjustment factor.

Productivity adjustment.—In our notice, we pointed out that the productivity adjustment issue had been extensively discussed in our earlier notice in this proceeding, but we again invited comments on our proposal not to adjust the rail cost adjustment factor for productivity increases. Once again, many parties contended that a productivity adjustment should be made. Their basic argument is that the AAR index, which is an

index of the costs of railroad transportation *inputs*, necessarily overstates the increase in the cost of producing railroad *outputs* (transportation services), to the extent productivity increases occur. We do not dispute the fact that productivity increases cause the costs of outputs to rise less rapidly than the costs of inputs; this is true by definition. In the light of comments received, however, we would like to explain more fully our reasons for continuing to believe that an input cost index, such as the AAR index, rather than an output cost index (i.e., one taking productivity into account), should be used for the purposes of section 203 of the Rail Act.

At the outset, we note that the Rail Act does not specify whether an input cost index or an output cost index is to be used as the rail cost adjustment factor. Instead, the Rail Act leaves this matter up to the Commission, as a matter of policy, to be determined in a manner consistent with the purpose of the Rail Act as a whole. In broad terms, we believe that the purpose of section 203 is to permit rail carriers to neutralize the effects of inflation through rate increases with minimal regulatory intervention. We see the rail cost adjustment factor as a reference point stabilized against inflation in the costs of goods and services the rail industry must purchase. From this reference point, the rail industry is to be free to make selective rate increases or decreases, as market conditions dictate, under the many other provisions of the Rail Act offering the railroads flexibility in changing their individual rates. Thus, while a rail cost adjustment factor based on an input cost index does not guarantee railroads full protection against inflation regardless of market conditions, it does remove unnecessary regulatory constraints on the attempts of railroads to cope with inflation. In keeping with this broad policy determination, several specific issues related to productivity adjustments must be addressed.

Several of the participants have disputed the initial view, presented in our notice, that rail productivity is impossible to measure due to a number of methodological problems. For example, the WCTL cites several studies of rail productivity some of which have apparently been accepted by the railroads. On further consideration, we now conclude that methodological problems of productivity measurement alone (although grave) do not preclude the development of productivity measures. We nevertheless question the reliability of such measures and as a matter of policy do not believe that their use is justified.

Some participants, particularly certain coal interests, disagree with the proposition, stated in our notice, that adjustment for rail productivity growth creates disincentives for rail efficiency. They contend that because the adjustment would reflect only average productivity growth, railroads with greater than average productivity gains would continue to

benefit from their better than average performance. As far as it goes, this argument is correct, but we note that it cuts both ways. Although an adjustment based on average productivity gains would not entirely eliminate incentives to railroads with better than average performance, it might unfairly penalize railroads with worse than average performance, when the conditions of improved performance are beyond the carrier's control. (As a hypothetical example, suppose a productivity breakthrough occurred for bulk commodities such as coal and grain; such a breakthrough would improve industry average statistics, but would be of litte benefit to railroads whose traffic was predominantly nonbulk in nature.) This defect could be cured only by making the productivity adjustment on a carrier-by-carrier basis. However, it is uncontested in the record that a carrier-by-carrier productivity adjustment would itself undermine railroad incentives.

It is also argued by some participants that a productivity adjustment is appropriate because productivity gains are typically passed along to consumers under competitive (unregulated) market conditions. We agree that this will often happen, but there is an important exception. The exception occurs when the competitive firms' revenues fail to cover their economic costs. Economic costs include the cost of capital, as well as operating expenses. Our past findings in revenue adequacy proceedings have been that few railroads earn revenues sufficient to cover their full economic costs. Thus, cost savings from productivity gains would not be passed on to shippers to the extent that such savings were required by the railroads to cover economic costs. A forced passthrough of these cost savings via the index would not create the investment climate that Congress seeks to promote in the railroad industry.

In sum, we will not adjust the rail cost index to reflect productivity gains as long as the railroad industry continues to earn inadequate revenues. We believe that this position is consistent with the intent of Congress that the index be used solely for the purpose of neutralizing the effects of inflation on regulation of the railroad industry. We wish to note that this decision does not preclude any railroad from passing through any or all cost savings from productivity gains. If an individual carrier wishes to pass on some of these cost savings to shippers, it may do so by taking less than the full increases permitted by the index.

Treatment of profit and fixed expenses.—In our notice, we asked for comment on whether an adjustment should be made to the rail cost adjustment factor to take into account profits and nonrecurring costs. After consideration of the comments submitted in this proceeding, we find no convincing reason for making such an adjustment. For the

reasons stated below, we believe that any such adjustment would be inconsistent with the intent of Congress that the index be used to neutralize the effects of inflation on the railroad industry, since it would frustrate the railroads' ability to earn normal profits.

So-called "normal" profit (that is, accounting profit including the cost of capital) and fixed (nonrecurring) costs representing long-lived used and useful capital assets are part of full economic costs, and must not be treated differently than those elements of cost that railroad accounting conventions classify as variable. It is a well-accepted principle of ratemaking that if revenues are not allowed to cover prospective costs of new assets, and to cover a normal profit on invested capital, the industry will be unable to attract necessary investment funds, to the ultimate detriment of shippers. To make a downward adjustment of the rail cost adjustment factor to exclude all profit and nonvariable expenses, would then, clearly be inconsistent with the principle of neutralizing the rail industry against the effects of cost inflation.

It has been suggested that while normal profit and long-term costs should be covered by the rail cost adjustment factor, profit in excess of normal, and return on investment not used and useful, should be excluded. There are legitimate controversies surrounding these issues. These controversies are being addressed fully in our proceeding Ex Parte No. 393, *Standards for Railroad Revenue Adequacy*, 364 I.C.C. 803 (1981). We believe that they need not be addressed here. Our findings in Ex Parte No. 393 suggest that the total value of nonused and nonuseful plant, and the total value of excess profits, are both very small in relation to railroad costs. Any changes over time in the ratio of these items to total rail costs would have only a slight effect on the rate of change of the rail cost adjustment factor. To invite sustained litigation for so little obvious benefit seems to us dubious as a matter of regulatory policy.

Some participants in this proceeding contend that even though railroads may not be earning excess profits overall, they may be earning excess profits on particular rates, and that those rates should thus not be subject to escalation by the full rail cost adjustment factor. We do not agree. Even assuming for the sake of argument that some rail rates may generate excessive profits for carriers not earning adequate revenues overall (or that some rail rates may contain undesirable cross-subsidies), we do not see this proceeding as the proper forum for resolving the problem. As stated above, the sole issue in this proceeding is the rate at which rates can increase to neutralize cost inflation. If shippers or carriers believe certain individual rates are unreasonably high in the base period, the correct solution is to address the reasonableness of the specific rate, rather than the method of adjusting rates. We will continue to assess the

reasonableness of rates either on a case-by-case basis for individual rates or, in the case of broad categories of rates, by such proceedings as Ex Parte No. 347 (Sub-No.1), *Coal Rate Guidelines—Nationwide*, 364 I.C.C. 360 (1980).

Finally, it has been argued that the rail cost adjustment factor should be adjusted to exclude profits because the Rail Act provides other channels, such as selective rate increases, through which the real (inflation adjusted) value of profits can be maintained.[1] Quite aside from the theoretical argument that normal profit is in fact a component of economic cost, we reject the suggestion that profits be excluded from the rail cost adjustment factor on grounds of administrative burden. We have consistently encouraged selective rate adjustments, both upward and downward. Nonetheless, if the real value of rail profits could be protected against inflationary erosion only by selective rate adjustments, the number of adjustments that railroads would have to make just to stay even with inflation would greatly increase. This would result in unnecessary additional regulatory proceedings and attendant costs for shippers, carriers, and the Commission alike. Such a course would run counter to our intention, and that of Congress, to streamline regulatory procedures, and reduce regulatory lag and administrative costs.

Frequancy of adjustment.—Section 203 of the Rail Act provides that the Commission shall publish the rail cost adjustment factor as often as practicable, but in no event less often than quarterly. Too long a period between adjustments can create a problem of regulatory lag. With regulatory lag, full cost recovery is never achieved because new cost increases occur before adjustment to past cost increases is permitted. In our notice, we proposed permitting quarterly increases based on the rail cost adjustment factor as projected to the midpoint of the quarter to which the rate changes will be applicable. This proposal occasioned little opposition, but we think it important, nonetheless, to restate our reasons for proceeding in this way. We believe that quarterly filings will provide a substantial administrative savings to shippers, carriers, and the Commission in comparison with monthly filings. At the same time, by employing a forecasted index, we will reduce regulatory lag to a level roughly equivalent to that which monthly change would achieve. In our notice, we recognized that under the forecasted quarterly index approach, rate increases in the first month of each quarter would slightly exceed those that would be allowed for the same month if we were using a monthly adjustment factor that did not involve forecasting. We also noted,

[1] The rate flexibility provided by these channels is intended to help the railroads to protect their profits from inflation. We believe, however, that Congress also intended that this additional flexibility be used, where appropriate, by the railroads to improve their real earnings. This issue is discussed above.

however, that in the last month of the quarter, rate increases would fall slightly short of those obtainable under the monthly method. However, we see the lower costs and reduction in regulatory lag that result from the forecasting approach as outweighing these monthly, and ultimately counterbalanced, imprecisions.

As indicated in the notice, we find the forecasting method (autoregression without intercept) outlined by AAR witnesses Roberts and Kellman to be reasonable. The Commission will propose revision if any problems arise, and will entertain any specific suggestions for improvement of the forecasting method made by any interested party. As explained in our order, to avoid the possibility of cumulative forecasting error, we will require that, for each quarter, the allowable percentage increase be calculated on the basis of the forecasted, rather thap actual, cost increases for the previous quarter. This prevents any party from benefiting or being penalized by a forecast error in any quarter when the net change for the next quarter is calculated. In our notice, we offered the following example: assume that actual and forecasted cost indexes for the second quarter of a given year are 100 and 103 respectively, and that the forecasted index for the third quarter (using the second quarter actual as a base) is 105. The allowable increase for the third quarter would be (105-103)/103 = 0.019 (that is, 1.9 percent), rather than (105-100)/100 - 0.05 (that is, 5 percent). In this way, the difference between the forecasted and real cost increases of the second quarter would be offset in the third quarter index.

We have decided to require the AAR, no later than 20 days before the end of each quarter, to calculate and submit to the Commission the actual index as of the midpoint of the current quarter and the forecasted index for the midpoint of the next quarter. Thus, for example, on March 10 of any year, the AAR would submit the actual index as it stood on February 15 of that year, together with the index as it is forecasted to stand as of May 15. The Commission would verify the index and make it available to the public at least 10 days before the end of the quarter. Railroads would then be able to raise their rates—individually or collectively—up to the level of the index any time after the first day of the quarter to which the forecasted index applies. (In the example given above, railroads could, any time after April 1, take increases up to the level of the index as forecasted to May 15, using the forecasted February 15 index as a reference point to avoid cumulative forecasting error.)

In addition to directives governing the frequency of the index, subsection 203(a) of the Rail Act also directs the Commission to make periodic adjustments in the index to reflect the changing composition of railroad costs. This adjustment would require that the weights applied to the

various input prices used in calculating the index be updated to reflect any changes in the importance of each input as a percent of total railroad costs. Because of seasonal fluctuations in the composition of railroad costs, adjustments in these weights cannot be practicably made more frequently than annually. Therefore, the Commission has decided that such adjustments will be made on an annual basis.

As noted above, most of the participants in this proceeding did not protest these procedures. Those who did protest did not raise major issues. For example, DOT argues that 10 days were insufficient for the Commission to verify the index. In response, we emphasize that all errors in any given index need not be corrected prior to this publication. Errors in earlier indexes can be rectified through appropriate adjustments in later ones. We believe this approach superior to the alternative of a less frequent adjustment. Such an alternative would extend the regulatory lag that we are trying to reduce through this rulemaking. In sum, the comments in this proceeding provided us with no strong justification for altering the procedures proposed in the notice for implementing the AAR index.

Averaging.—The railroads continue to argue in favor of rules permitting them to submit a package of rate changes that average out to the allowed index—with some of the changes above and others below the increase permitted by the index. As stated in the notice, a central benefit of the rules established here, in comparison with past general rate increase procedures, is to divorce the problem of inflationary cost recovery from that of changes in the rate structure. Both are necessary, but the mixing of the two in past general rate increase proceedings has resulted in heavy procedural burdens.

We acknowledge that to the extent flag-outs and holddowns occur, carriers will not be able, through these procedures, to recover the full cost increase as measured by the index. For two reasons, however, we believe it is not necessary to offer an iron-clad guarantee of recovery of the full index under these new rules. Our first reason is that our proposal to reduce regulatory lag through forecasting of the index may well in itself be sufficient to ensure more complete cost recovery than has been possible under our existing general increase procedures. In addition, we believe that the Rail Act provides ample opportunities in addition to the index to raise individual rates by a factor exceeding the rail cost adjustment factor. We call attention particularly to the 6-percent annual adjustment permitted under section 10707a(c)(1). It is our goal in this and other proceedings not to guarantee through any set of rules or procedures a particular level of revenues for any railroad, but to assure that

needless regulatory barriers do not prevent railroads from earning such revenues.

Regional differences.—The railroads proposed that carriers be permitted to increase their rates by the amount of the AAR index for the Nation as a whole, or the index for their own region, whichever is greater. In our notice, we tentatively rejected this proposal, on the grounds that it would permit the actual national average level of rates to increase more rapidly than the national average of costs. Further, as one participant indicated, it would be equally rational to require the railroads to use the lower of the regional and national indexes.

None of the comments offered new or persuasive reasons for abandoning this line of reasoning. We therefore, deny the railroad request for regional indexes.

Collective ratemaking under the proposed rules.—In our advance notice, we raised the possibility that increases under the index not be fully available for rate changes made collectively within the rate bureaus. In the subsequent notice we withdrew this possibility, and we continue to believe that it would be improper to use our rules covering inflationary cost recovery as a means for effecting changes in collective ratemaking. Further, subsection 219(f) of the Rail Act states that, "the Commission may not take any action with respect to the elimination of general rate increases or decreases prior to April 1, 1982." As to the interaction between independent and collective rate adjustments, we must ensure that, pursuant to new section 10707a(b)(3), carriers do not use the index to increase individual rates to cover inflation after they have recovered these same inflation costs collectively. We will, in another proceeding, propose rules governing the tariff filing of rates under section 10707a, similar to the rules we have established for the motor carrier zone of rate flexibility filings. These rules require that a carrier clearly indicate that portion of the zone remaining available for use on individual rates. We believe that the timing of individual and collective inflation adjustments may not be used to effect double recovery. This position was not seriously contested.

Fuel surcharge.—As indicated in the notice, the procedures established in this decision will permit railroads to recover fuel cost increases along with other cost increases on a quarterly basis. Regulatory lag will be minimal under the proposed forecasting method. Maintaining a separate surcharge mechanism for fuel would, in our view, serve no useful purpose once these rules are in place, and would, in fact, only complicate the operation of the new system. All parties will benefit from avoiding separate tariff supplements for fuel increases. Special Permission 79-2620, which allows the filing of fuel cost surcharges on short notice, will no longer be available to railroads.

RAILROAD COST RECOVERY PROCEDURES

Title 49, Part 1102, Section 1102.1 is amended by revising to read as follows:

Sec. 1102.1 Railroad Cost Recovery Procedures

(a) Rail carriers may adjust rates and charges quarterly in order to compensate for inflationary cost increases. The quarterly adjustment shall not for any rate exceed the percentage change in the Associaton of American Railroads' Index of Railroad Material Prices and Wage Rates as supplemented by the Producer Price Index for those costs not covered by the AAR Index. The Commission will make modifications or revisions to the index, as necessary. Until at least April 1, 1982, these procedures are available for collective adjustment of rates.

(b) The allowable increase will be based on a projection of the index to the midpoint of the quarter to which the index will apply. In order to avoid cumulative forecasting error, the percentage change must be calculated from a comparison of the forecast index for the midpoint of the quarter during which the rates will be in effect with the forecast index for the midpoint of the previous quarter.

(c) The AAR must file with the Commission no later than 20 days before the end of each quarter its calculation of the actual index as of the midpoint of the current quarter and the forecasted index for the midpoint of the next quarter.

(d) Tariffs containing adjustments under the provisions of this rule may be filed to become effective on not less than 1 day's notice.

(e) Increases in rates consistent with these standards will not be investigated or suspended by the Commission unless the filing results in a double recovery of inflation-based cost increases.

CONCLUSION

This decision will not significantly affect the quality of the human environment or conservation of energy resources. Although this proceeding is not subject to Public Law 96-354, it is our opinion that it will not have a significant adverse impact on a substantial number of small entities. The AAR may immediately submit the actual index of the midpoint of the first quarter of 1981 and the forecasted index for the second quarter of 1981. As of the effective date of this decision, rail carriers may implement rate increases in accordance with the revised rules contained in 49 CFR 1102.1.

Authority: 49 U.S.C. 10321, 10701a, 5 U.S.C. 553.

By the Commission, Acting Chairman Alexis, Commissioners Gresham, Clapp, Trantum, and Gilliam.

(SEAL)

AGATHA L. MERGENOVICH,
Secretary.

APPENDIX A

Description of the methodology used in computing the AAR's indexes of railroad material prices and wage rates

JAMES LUNDGREN
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OFFICE OF POLICY AND ANALYSIS
INTERSTATE COMMERCE COMMISSION
JULY 1980

Introduction.—The Economics and Finance Department of the AAR has compiled indexes showing trends in average unit prices of railroad fuel, material and supplies, and wage rates since 1933. The indexes for fuel, material and supplies are designed to measure only changes in prices. They do not measure changes in volumes or total costs of such purchases. The indexes for wage rates reflect changes in the average straight-time hourly rate for all railroad employees, but do not reflect changes in the level of employment or productivity. A second wage index is also computed which reflects in addition to the straight-time hourly rate: payroll taxes, health and welfare benefits, and allowances for paid vacations and holidays.

Price data.—The 65 items for which price data are presently gathered were chosen by a special committee of railroad purchasing agents. (See appendix A-1 for a listing of these items.) These items were each selected on a judgment basis to be typical (representative) of its class of railroad purchases. They collectively account for 91 percent of all materials and supplies (including fuel) purchased by class I railroads. The following three criteria were used in choosing this list: (1) the item is purchased by the railroads in large quantities, (2) the item is purchased by most roads, and (3) the item's price trend closely parallels the price trend of related materials. The list is periodically updated to reflect changes in the pattern of railroad purchases. It was last updated January 1975 and will be updated again when the new index is implemented. At that time 6 items will be removed from this list of 65 items. These six include car lining, insulated rail joint, track bolts, portland cement, paper grain doors, and unmounted airbrake hose. These six items represented less than 2 percent of purchases in 1974.

There are now 10 railroads which report their list price for each of these 65 items four times a year (January 1, April 1, July 1, and October 1). These 10 railroads which account for approximately two-thirds of all class I railroad purchases are:

Eastern roads:
- Chessie System
- Consolidated Rail Corporation

Southern roads:
- Illinois Central Gulf
- Louisville & Nashville
- Southern System

Western roads:
Atchison, Topeka & Santa Fe
Burlington Northern
Missouri Pacific
Southern Pacific
Union Pacific

Item spot indexes.—A Laspeyres index weighting system is used to compute an index for each of the 65 items using the following formula:

$$I_{tjr} = \frac{\sum_{i_r=1}^{n_r} P_{i_r tj} \; Q_{i_r 74j}}{\sum_{i_r=1}^{n_r} P_{i_r 75j} \; Q_{i_r 74j}}$$

Where:

I_{tjr} = the index of item j, at time t, for region r with base January 1, 1975,

$P_{i_r tj}$ = the price of item j for the i_rth railroad in region r at time t,

$P_{i_r 75j}$ = the price of item j for the i_rth railroad in region r for January 1, 1975,

$Q_{i_r 74j}$ = the quantity of item j purchased by the i_rth railroad in region r in 1974 as measured in units purchased (gallons, number of ties, et cetera but not dollars),

n_r = number of railroads in region r,

n_1 = 2 for the eastern region,

n_2 = 3 for the southern region,

n_3 = 5 for the western region.

The 65 spot price indexes computed in this manner for each of the three regions (195 indexes) are then combined into four general groups, as follows:

1. Fuel (1 item),
2. Forest products (8 items),
3. Iron and steel products (23 items), and
4. Miscellaneous products (33 items).

The following formula is used to combine item spot indexes into group spot indexes:

$$I_{tkr} = \frac{\sum_{j_k=1}^{m_k} W_{74j_k r} \; I_{tj_k r}}{\sum_{j_k=1}^{m_k} W_{74j_k r}}$$

Where:

I_{tkr} = the spot index for time t, group k, and region r,

$W_{74j_k r}$ = dollars spent in region r for item j in group k in 1974 for all class I railroads as computed from data collected on the AAR's Purchases of Fuel, Material and Supplies, Calendar year 1974, (see appendix A-2)

m_r = number of items in group k,

m_1 = 1 for fuel,

m_2 = 8 for forest products,

m_3 = 23 for iron and steel products,

m_4 = 33 for miscellaneous products.

Similarly the national spot index for each group k at time t would be:

$$I_{tk} = \frac{\sum_{r=1}^{3} \sum_{j_k=1}^{m_k} W_{74j_k r} I_{tj_k r}}{\sum_{r=1}^{3} \sum_{j_k=1}^{m_k} W_{74j_k r}}$$

The total materials and supplies spot price index for time t and region r is:

$$I_{tr} = \frac{\sum_{k=a}^{4} \sum_{j_k=1}^{m_k} W_{74j_k r} I_{tj_k r}}{\sum_{k=a}^{4} \sum_{j_k=1}^{m_k} W_{74j_k r}}$$

Where:

a = 1 when computing materials and supplies index including fuel,

a = 2 when computing materials and supplies index excluding fuel.

It should be noted that the item spot indexes ($I_{tj_k r}$) were computed by using January 1, 1975 as a base. Therefore in order to publish indexes with 1967 as a base year, each of the indexes was multiplied by its respective 1967 base year index for January 1, 1975. For example:

$$I_{t_{67}} = (I_{t_{75}})(I_{75_{67}})$$

Where:

$I_{t_{67}}$ = an index for time t using base year 1967.

Appendix A-3 contains an example of these group spot indexes by region and for the United States.

Item charge-out indexes.—So far we have described the computation of spot price indexes which reflect the price of items at the time of purchase. Charge-out indexes are computed to reflect the approximate purchase price of items as they are used. This is done by allowing the charge-out index to lag behind the spot price index by the average length of time fuel, or materials and supplies are held in stock or on hand before being used.

Inventory turnover and advice from purchasing officers have been used to determine that fuels were generally kept on hand in 1 month's supply and all other materials and supplies in about 3 month's supply. The lag time for materials and supplies other than fuel was found by dividing the inventory value by the amount purchased in 1 year (both from the Annual Report Form R-1, ICC) and multiplying this quotient by 12 months. Since the inventory for fuel is not known, the lag time for fuel was a subjective estimate based upon the advice of purchasing officers.

Because of the 3-month lag time a quarterly charge-out index for all material and supplies except fuel is equal to its spot price index for the prior quarter.

The quarterly charge-out indexes for fuel need to be interpolated since their lag is only 1 month. This is done by adding two thirds of the current quarter's spot price index to one third of the prior quarter's spot price index to get the current charge-out index for fuel. For example, April's charge-out index for fuel is equal to two-thirds of April's spot price index for fuel plus one-third of January's spot price index for fuel. These computations are made on the January 1, 1975 base indexes which are combined where desired and then changed to reflect 1967 as a base year just as in the spot price index. Appendix A-4 shows these charge-out indexes for fuel, and materials and supplies.

Wage index.—The average annual straight time rates of pay are computed by dividing the latest annual straight time compensation by straight time hours paid for from the Interstate Commerce Commission statement A-300, "Wage Statistics of Class I Railroads in the United States." Each average is then divided by the corresponding average straight time rate of pay in 1967 (and multiplied by 100) to get a straight time wage rate index using base year 1967.

Quarterly updates to the straight time wage rate index are computed by checking the union contracts. There are over 20 unions serving railroad workers. However, in recent history they have always had the same pattern of increases. Also although the unions do not represent all railroad employees (management being the major exception), they do represent approximately 95 percent and the other 5 percent are assumed to receive similar pay changes as union workers.

Another set of indexes is developed which reflects wages and supplements. The annual total of wages and supplements is computed by adding straight time compensation to payroll taxes and health and welfare benefits (Annual Report Form R-1, ICC) plus other allowances (ICC Wage Statistics Forms A and B). Payroll taxes include retirement, medicare, unemployment insurance, and supplemental annuities. Other allowances includes holiday and vacation pay. This total of wages and supplements is divided by annual straight time hours paid for (ICC Wage Statistics Forms A and B) and the result is changed into index form with 1967 as the base year.

These supplements are updated quarterly by information from the National Railway Labor Conference and the Railroad Retirement Board.

Appendix A-4 contains quarterly wage rate indexes and wages and supplements as well as indexes showing the combined effect of these with materials and supplies, and/or fuel. Weighting factors used to combine these indexes are based upon the total dollars spent by all class I railroads in 1974 in each of these four categories by region or for the United States (as reported in the ICC's Wage Statistics Forms A and B, the Annual Report Form R-1, and the AAR's special study Form MS-74.)

Annual indexes.—Appendix A-5 contains a table of AAR's Annual Indexes of Charge-out Prices and Wage Rates. The annual indexes of wage rates, and wages and supplements are developed as described in the prior section "Wage index."

The annual indexes for fuel, and materials and supplies are developed from the quarterly spot price index with weighting factors to allow for the lag times. The annual charge-out index for fuel for year n is computed by using the following formula:

$$I_{nf} = (5/6)(.25)(I_{jn}) + .25(I_{an} + I_{yn} + I_{on}) + (1/6)).25)(I_{j(n+1)})$$

Where:

I_{nf} = charge-out fuel index for year n,
I_{jn} = spot price index for January during year n,
I_{an} = spot price index for April during year n,
I_{yn} = spot price index for July during year n,
I_{on} = spot price index for October during year h,
$I_{j(n+1)}$ = spot price index for January during year n+1.

The annual charge-out index for materials and supplies other than fuel for year n is computed by using the following formula:

$$I_{nm\&s} = .125(I_{o(n-1)} + I_{on}) + .25\ (I_{jn} + I_{an} + I_{yn})$$

Where:

$I_{nm\&s}$ = charge-out material and supplies index for year n, and the other indexes in the above equation use the same notation as in the fuel index equation but now refer to the material and supplies indexes.

The seme weighting techniques are used to combine these indexes as are used in the quarterly indexes. (The weighting factors are based upon total dollars spent by all class I railroads in 1974 in each category.)

Unit adjustments.—The specifications used to describe each of the 65 items in the materials and supplies indexes are not always the same from one railroad to the next. For example one railroad might use 115-pound rail and another might use 135-pound rail. Normally, these differences do not affect the validity of the indexes. However, if one railroad switches from 115 to 135-pound rail the result would be quite noticeable if an adjustment were not made.

When a different unit is used by a railroad for 1 of the 65 items the new unit price is multiplied by the ratio of the prior quarter's unit price to the new units price in the prior quarters. For example:

$$\text{Adjusted April unit price} = \text{(new units April Price)} \times \frac{\text{(old units January price)}}{\text{(new units January price)}}$$

This adjustment factor (for January in this example) would need to be used until after the next special study.

Retroactive pay increases.—Occasionally union wage contracts are not finalized until after the old contracts have expired. In such cases the increase in pay must be paid retroactively. No projections are made for retroactive pay increases. However, these increases do represent a cost to the railroads which is for the most part accrued over the time period prior to the actual payment of retroactive pay. To display more stability in a gradually changing index, the indexes are revised (after publication if necessary) to reflect retroactive pay increases during the period over which they were earned rather than when they were paid.

APPENDIX A-1

AAR MATERIAL PRICE QUESTIONNAIRE

Form P-774-1

Section 1: Quantities of fuel and materials of general use and descriptions of items to be reported.

Name of Railroad _____

Item No.	Item and AAR Standard Material Classification Number	Quantity used or purchased in 1974 (all sizes and kinds)	Description of specific item on which prices will be reported.
	(a)	(b)	(c)
1	Fuel Diesel fuel oil (27 & 39)		
2	Forest Products Bridge ties (4)		
3	Piling (4)		
4	Stringers (4)		
5	Cross ties (treated) (3)		
6	Switch ties (3)		
7	Flooring, car (30)		
8	Lining, car (30)		
9	Plywood, for freight car lining (30)		
10	Iron & Steel Products Rail anchors (1)		
11	Rail joint, insulated (1)		
12	Tie plates (1)		
13	Track bolts (1)		
14	Track frogs (1)		
15	Track spikes (1)		
16	Rail, new (8)		
17	Springs, coil, freight car (12)		
18	Steel, bar (13)		
19	Steel plates (13)		
20	Steel sheets (13)		

AAR MATERIAL PRICE QUESTIONNAIRE

Form P-74-1

Section 1 (concluded)

RR _____

Item No.	(a)	(b)	(c)
	Iron & Steel Prods. (cont.)		
32a	Steel, struct. shapes, unfabricated (15)		
32	Beams, brake, freight (20)		
33	Brake shoes, freight car, composition (20)		
34	Couplers, freight car (20)		
35	Draft gears, freight car (20)		
36	Roller bearings, freight car (20)		
37 b	Axles, freight car (19)		
38	Wheels, steel, freight car (19)		
39	Wheels, steel, loco., unit.-rear rolled (19)		
30	Pipe, steel (24)		
31	Fasteners with collar (25)		
32	Welding rod and wire (25)		
	Miscellaneous Products		
33	Recorder, signal (2)		
34	Rail signal bonds (2)		
35	Signal cable, under-ground (2)		
36	Signal relays (2)		
37 c	Cement, Portland (3)		
38	Culvert pipe, corrugated metal (3)		
39	Ballast (7)		
40	Truck tires (10)		
41	Journal bearings (21) (conversion cost)		
42	Traction motor support bearing (21) (conv. cost)		
43	Coupling, airbrake hose, w/o gasket (22)		

AAR MATERIAL PRICE QUESTIONNAIRE

Form P-74-1

Section 1 (continued)

RR _____

Item No.	(a)	(b)	(c)
	Miscellaneous Products(cont)		
46	Batteries, storage, diesel loco. (35)		
46	Hand lantern batteries (35)		
46a	Traction motor armature overbind bine(or unit anchores (35)		
47	Traction motor brushes (35)		
48a	Traction motor roller bearings, commutator end (new) (35)		
49	Cylinder liners for diesel loco. (36)		
50	Cylinder heads for diesel locos. (new) (36)		
51	Diesel engine lub'g. oil filters (36)		
52	Pistons for diesel locomotives (new) (36)		
53	Pistons (36)		
54	Grain doors, paper (36)		
55a	Car oil (37)		
56	Lubricator pads, frt. car journ. box (37)		
57a	Oil diesel lubricating (incl. car) (37)		
58	Traction motor gear lubricants (37)		
59	Hose, airbrake, unmounted (44)		
60	Cleaners, locomotive (47)		
61	Creosote oil (47)		
62	Gas, acetylene (47)		
63	Gas, oxygen (47)		
64	Paint, freight car (47)		
65	Computer paper, continuous unruled (47)		

AAR MATERIAL PRICE QUESTIONNAIRE

Form P-74-1

Section 2: Prices paid or quoted.

Name of Railroad _____

Item No.	Item and AAR Standard Material Classification Number	Unit of Measure	Price per unit $			
			Jan 1 19__	Apr 1 19__	July 1 19__	Oct 1 19__
	(a)	(d)	(e)	(f)	(g)	(h)
1	**Fuel** Diesel fuel oil (27 & 29)	Gallon				
2	**Forest Products** Bridge ties (4)	M.B.F.				
3	Piling (4)	Linear ft.				
4	Stringers (4)	M.B.F.				
5	Cross ties (treated) (3)	Each				
6	Switch ties (3)	M.B.F.				
7	Flooring, car,(30),	M.B.F.				
8	Lining, car (30)	M.B.F.				
9	Plywood, for freight car lining (30)	Sheet				
10	**Iron & Steel Products** Rail anchors (1)	Each				
11[2]	Rail joint, insulated (1)	Pair				
12[2]	Tie plates (1)	Ton				
13	Track bolts (1)	Pound				
14	Track spugs (1)	Each				
15	Track spikes (1)	Pound				
16[2]	Rail, new (8)	Net ton				
17	Springs, coil, freight car (12)	Each				
18[2]	Steel, bar (13)	Pound				
19[2]	Steel plates (13)	Pound				
20	Steel sheets (13)	Pound				

AAR MATERIAL PRICE QUESTIONNAIRE

Form P-7-4-1

Section 3 (Continued) RR _____

Item No.	(a)	(d)	Jan 1	Apr 1	July 1	Oct 1
			(e)	(f)	(g)	(h)
	Iron & Steel Products(cont.)					
32½	Steel, struct. shapes, unfabricated (12)	Pound				
33	Beams, brake, freight (20)	Each				
34	Brake shoes, freight car, composition (20)	Each				
35	Couplers, freight car (20)	Each				
36	Draft gears, freight car (20)	Each				
37	Roller bearings, freight car (20)	Each				
37½	Axles, freight car (29)	Each				
38	Wheels, cast, freight car (29)	Each				
39	Wheels, steel, incl. axle--car rolled (29)	Each				
40	Pipe, steel (36)	Foot				
41	Fasteners with collar (45)	Each				
42	Welding rod and wire (45)	Pound				
	Miscellaneous Products					
43	Semaphore, signal (2)	Each				
44	Rail signal bonds (2)	Each				
45	Signal cable, underground (2)	M. ft.				
46	Signal relays (2)	Each				
47	Cement, Portland (3)	Barrel				
48	Culvert pipe, corrugated metal (7)	Foot				
49	Ballast (7)	Ton				
40	Truck tires (10)	Each				
41	Journal bearings (21) (suspension gear)	Pound				
42	Traction motor support bearing (21) (susp. gear)	Each				
43	Coupling, sidewise base, w/o gasket (22)	Each				

AAR MATERIAL PRICE QUESTIONNAIRE

Form P-7-4-1

Section 3 (Continued) RR_____

Item No.	(a)	(d)	Jan 1 (e)	Apr 1 (f)	July 1 (g)	Oct 1 (h)
	Miscellaneous Prods.(cont.)					
44	Batteries, storage, diesel loco. (25)	Set				
45	Head lamore batteries (25)	Each				
46	Traction motor armature rewinding kits(or unit exchange (25)	Each				
47	Traction motor brushes (25)	Each				
48	Traction motor roller bearings, commutator end (new) (25)	Each				
49	Cylinder liners for diesel locos. (26)	Each				
50	Cylinder heads for diesel locos. (new) (26)	Each				
51	Diesel engine lub'g. oil filters (26)	Each				
52	Pistons for diesel locomotives (new) (26)	Each				
53	Fusees (36)	Gross				
54	Grain doors, paper (36)	Car set				
55	Car oil (37)	Gallon				
56	Lubricator pads, frt. car journ. box (37)	Car set				
57	Oil diesel lubricating (Locl. tan) (37)	Gallon				
58	Traction motor gear lubricant (37)	Pound				
59	Hose, airbrake, unmounted (46)	Each				
60	Creosote, locomotive (47)	Gallon				
61	Creosote oil (47)	Gallon				
62	Gas, acetylene (47)	Cubic ft.				
63	Gas, oxygen (47)	Cubic ft.				
64	Paint, freight car (47)	Gallon				
65	Computer paper, continuous manifold (47)	1000 sheets				

AAR MATERIAL PRICE QUESTIONNAIRE

Form P-74-1

NOTES

a *Unit price* should be the actual invoice price, based on actual purchases. If no purchases were made on reporting date and a quantity is shown in Col. (b), a quoted price should be reported. All prices reported should be f.o.b. producing points, except where it is the trade practice to name a delivered price or make allowances for freight equalization purposes. Sales, use, or inspection taxes should be excluded from unit prices reported. When a change in the "unit price" is due to a cause other than an actual price change, e.g., a change in specification, volume discounts, etc., attach a memorandum of explanation and *furnish a unit price for the prior reporting period* comparable with the new unit price reported.

b *Iron and Steel Products - Items 11, 12, 16, 18, 19, 20, 21, and 27.* In reporting prices for these steel products, select a typical item in each of those categories and furnish a price for that item, including all extras paid when purchased. For example, in the case of Item 18, Bar Steel, a typical size might be 3/4" round, 18-22' Grade 1015. The current price may be $5.00 per 100#, but including extras applied for size and special bar quality, the actual price of this item may be $5.45 per 100#. The price of $5.45 should be reported. For Item 16, Rail, price reported should *exclude* inspection fees and use taxes, but should *include* controlled cooling charges.

c *Cement, Portland - Item 37.* Amounts used in ready-mixed concrete should be included in quantities shown in Col. (b).

d *Traction motor armature rewinding kits - Item 46; Traction motor roller bearings - Item 48.* Roads sending traction motors or roller bearings to manufacturers for repair should develop a price on rewinding kits or roller bearings and report the developed price for appropriate period or report a price on a unit exchange basis. Report in Col. (b) the number of traction motors and roller bearings returned to manufacturers and/or repaired in own shops.

e *Car oil - Item 55; Oil, diesel lubricating - Item 57.* Prices reported for these items should include Federal excise tax only - other taxes should be excluded.

Sheets 4, 5 and 6 to be submitted as promptly as possible after each pricing date to:

Association of AMERICAN RAILROADS
Economics & Finance Department
American Railroads Bldg.
1920 L Street, N. W.
Washington, D. C. 20036

APPENDIX A-2

The attached Form MS-74 Purchases of Fuel, Material and Supplies, Calendar Year 1974 was completed by all class I railroads for 1974 as a special study to update the weighting factors for combining the item indexes for materials and supplies. A similar special study will be conducted for 1980.

It should be noted that there are only 32 items on Form MS-74 compared with 65 items on Form P-74-1 (attachment A) which is completed by the 10 selected railroads. Each of the list of 32 items is the sum of one or more items from the list of 65 items and each of the 65 items is contained in one of the 32 items. Therefore, to develop an estimate of the total purchases for each of the 65 items it is sometimes necessary to estimate its proportion of the total cost of one of the 32 items. This is done by using information collected from the 10 railroads on Form P-74-1. For example if 10 percent of the cost of wooden crossties for the 10 railroads is for bridge ties then it is assumed that 10 percent of all class I railroad's cost of wooden crossties is for bridge ties.

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APPENDIX A-3

2. Quarterly indexes of spot prices of railroad fuel, material and supplies (average 1967 = 100)

District and Group	July 1967	July 1968	July 1969	July 1970	July 1971	July 1972	Oct. 1972	Jan. 1973	Apr. 1973	July 1973	Oct. 1973	Jan. 1974	Apr. 1974	July 1974	Oct. 1974	Jan. 1975	Apr. 1975	July 1975	Oct. 1975	Jan. 1976	Apr. 1976	July 1976	Oct. 1976	Jan. 1977	Apr. 1977
UNITED STATES:																									
Fuel (diesel oil)	99.7	104.0	106.5	110.2	114.5	117.5	118.3	119.4	127.1	138.7	148.7	191.6	271.2	295.5	309.1	313.7	311.5	318.4	337.2	349.5	363.1	368.5	384.8	363.3	389.9
Forest products	99.7	104.6	114.4	121.3	125.8	131.0	131.9	134.7	144.2	150.2	159.0	170.5	187.7	200.4	213.1	221.0	220.8	221.0	215.9	215.7	215.7	215.3	217.2	217.0	225.2
Iron & steel prod.	99.7	101.9	105.1	109.9	117.3	126.6	125.2	127.5	128.2	129.7	130.9	136.8	149.6	175.0	190.2	206.5	206.5	207.2	212.3	212.3	212.3	219.0	219.8	223.7	224.1
Miscellaneous prod.	100.2	103.1	105.2	108.6	112.8	116.7	115.2	115.3	116.4	119.3	121.3	127.1	136.7	150.9	159.9	170.9	174.7	180.5	182.5	187.8	196.5	199.0	202.5	208.3	213.
Total, excl. Fuel	99.9	102.8	107.0	110.3	115.9	120.1	120.7	121.9	123.7	126.3	128.5	136.9	146.5	164.9	176.7	188.7	191.3	196.6	196.6	199.3	202.7	207.0	209.6	213.8	216.9
Total, incl. Fuel	99.9	103.0	106.1	110.2	115.3	119.2	119.9	121.1	124.5	129.7	134.2	150.9	181.9	202.0	214.2	224.1	225.4	229.7	236.2	241.6	242.0	247.4	250.5	255.9	263.1
EASTERN DISTRICT:																									
Fuel (diesel oil)	100.7	105.0	106.4	109.7	114.0	117.5	119.5	120.8	126.2	143.8	146.3	195.1	262.1	296.2	311.6	321.2	308.7	319.0	340.0	355.6	365.9	366.0	353.6	365.2	397.3
Forest products	100.1	102.3	108.1	114.0	118.7	123.6	123.5	127.6	131.0	133.9	143.9	156.6	165.5	179.0	195.5	196.1	200.3	198.5	193.3	192.9	200.5	206.4	206.6	208.4	212.4
Iron & steel prod.	99.6	101.9	104.6	109.2	115.8	122.2	124.2	125.3	125.7	126.5	127.3	134.0	148.6	170.6	191.6	201.0	203.2	204.6	201.2	202.0	202.0	207.2	207.7	213.5	213.3
Miscellaneous prod.	100.6	103.2	105.9	110.6	116.5	117.1	117.0	117.9	119.2	122.3	122.8	128.6	141.6	152.2	166.3	177.0	174.7	180.6	187.3	191.0	196.1	202.7	206.6	209.6	212.8
Total, excl. Fuel	100.2	102.6	105.6	110.5	115.3	119.5	120.7	121.5	122.6	126.8	126.3	133.0	146.1	161.6	170.3	180.2	180.2	190.8	191.6	193.5	197.7	202.2	206.6	208.5	210.2
Total, incl. Fuel	100.3	103.2	105.8	110.0	114.9	119.0	120.3	121.3	123.6	130.1	131.8	150.2	178.3	198.8	215.3	223.2	221.8	226.6	232.9	236.0	236.9	242.5	245.9	251.8	261.3
SOUTHERN DISTRICT:																									
Fuel (diesel oil)	98.8	105.3	103.2	106.4	111.1	114.7	112.6	115.1	125.4	129.9	140.8	184.5	253.3	275.9	289.0	282.8	291.8	297.5	312.8	324.7	319.3	318.7	326.4	336.6	364.2
Forest products	100.2	101.5	106.8	116.7	123.3	132.4	133.7	132.3	141.2	145.2	148.7	155.9	169.7	197.9	212.9	217.2	220.2	221.1	214.4	217.6	215.7	213.9	223.5	225.7	227.4
Iron & steel prod.	99.9	102.1	105.0	107.5	116.0	122.9	123.2	126.2	127.6	128.5	128.1	136.2	149.8	176.5	187.7	199.3	201.7	203.5	212.1	211.9	212.5	220.8	221.6	225.4	226.2
Miscellaneous prod.	100.6	103.3	108.5	109.0	113.0	115.1	115.1	115.3	116.3	118.7	119.5	126.0	134.3	150.9	158.6	172.3	175.1	180.1	182.1	183.8	188.5	190.9	194.3	199.2	205.9
Total, excl. Fuel	100.2	102.6	105.7	109.3	115.2	119.9	120.1	121.1	123.1	125.1	125.9	133.2	143.8	164.6	176.9	186.9	189.5	192.5	195.7	196.8	198.7	202.4	206.2	209.9	213.3
Total, incl. Fuel	99.9	103.2	105.0	108.5	114.1	118.6	118.0	119.4	123.7	126.4	129.6	141.5	173.6	194.3	205.6	212.5	216.8	220.6	227.0	231.0	231.0	233.3	238.4	243.3	253.7
WESTERN DISTRICT:																									
Fuel (diesel oil)	99.5	103.0	106.1	113.2	116.5	118.8	119.6	120.2	128.4	138.7	154.0	200.0	295.9	303.2	316.0	321.2	319.9	325.1	344.3	354.6	354.0	360.1	365.2	372.3	395.4
Forest products	99.3	107.7	123.7	127.4	132.0	136.4	136.2	141.8	158.6	167.7	183.4	195.9	224.0	229.0	228.2	242.2	239.3	239.3	234.7	232.3	225.7	227.4	226.0	223.8	237.1
Iron & steel prod.	99.8	101.7	104.3	110.3	116.9	123.9	124.0	126.9	127.8	130.3	132.3	136.7	148.0	172.9	186.6	203.0	205.0	206.8	211.7	211.1	211.7	217.6	218.2	221.7	221.7
Miscellaneous prod.	100.1	103.2	106.3	107.6	111.8	112.9	114.0	114.0	115.5	118.4	122.4	127.2	136.7	152.2	160.1	169.7	176.1	182.3	183.3	189.4	197.2	203.3	205.7	212.1	215.9
Total, excl. Fuel	99.9	103.1	106.4	110.7	116.0	119.6	120.5	122.1	126.7	128.0	132.2	137.5	149.7	167.1	177.0	190.2	194.3	197.7	200.2	203.1	206.9	212.6	213.9	218.5	221.9
Total, incl. Fuel	99.8	103.0	106.9	111.4	116.1	119.3	120.3	121.5	125.8	131.2	138.7	156.3	190.3	207.8	219.0	229.5	232.3	236.2	243.0	247.9	250.8	256.6	259.1	264.6	273.1

See footnote at end of table

APPENDIX A-3—Continued

2. Quarterly indexes of spot prices of railroad fuel, material and supplies (average 1967 = 100)—Continued

District and Group	July 1977	Oct. 1977	Jan. 1978	Apr. 1978	July 1978	Oct. 1978	Jan. 1979	Apr. 1979	July 1979	Oct. 1979	Jan. 1980	Apr. 1980
EASTERN DISTRICT:												
Fuel (diesel oil)	398.1	399.7	405.0	406.3	409.4	448.0	435.4	491.6	509.1	709.2	837.3	911.0
Forest products	229.4	236.0	240.0	240.9	250.8	252.6	264.5	272.3	286.2	297.1	321.6	333.9
Iron & steel prod.	230.1	233.1	235.4	242.5	245.8	252.4	263.0	268.7	277.5	296.9	305.3	310.0
Miscellaneous prod.	215.7	218.2	220.1	221.3	222.5	227.0	231.1	234.3	245.7	250.4	261.1	273.0
Total, excl. Fuel	221.3	226.4	227.0	230.2	233.4	239.1	245.7	250.4	260.2	268.3	283.6	293.8
Total, incl. Fuel	270.7	273.4	276.5	279.5	281.5	286.8	296.3	316.9	307.3	406.7	430.9	457.6
SOUTHERN DISTRICT:												
Fuel (diesel oil)	408.9	407.0	413.4	417.0	411.1	415.0	435.2	501.4	519.6	760.9	813.3	881.4
Forest products	217.9	220.9	224.8	225.4	234.2	237.5	251.0	254.6	267.0	276.8	280.9	282.1
Iron & steel prod.	218.5	221.6	221.6	229.9	234.1	240.1	251.6	257.1	266.0	274.0	290.6	296.6
Miscellaneous prod.	213.1	215.6	216.8	218.6	222.0	224.4	231.0	232.4	242.8	250.6	257.4	263.9
Total, excl. Fuel	213.4	216.2	217.2	221.5	226.0	230.2	239.6	243.0	253.9	260.6	271.4	276.7
Total, incl. Fuel	266.9	268.4	270.9	273.2	277.0	280.8	291.2	313.0	330.9	393.0	414.4	436.0
NORTHWESTERN DISTRICT:												
Fuel (diesel oil)	371.9	372.2	377.3	374.4	338.4	375.8	395.9	444.8	501.6	663.4	711.8	794.4
Forest products	232.2	238.6	240.2	242.0	255.4	258.7	266.5	276.9	288.4	299.7	309.7	315.0
Iron & steel prod.	232.6	236.2	238.0	245.5	247.3	254.3	263.1	269.3	277.4	298.0	304.5	308.5
Miscellaneous prod.	209.0	211.1	213.7	213.1	213.5	217.8	219.9	224.0	234.2	235.9	247.1	251.7
Total, excl. Fuel	217.9	220.0	223.3	226.1	229.5	234.7	240.4	246.3	254.0	262.4	275.2	284.1
Total, incl. Fuel	259.3	260.7	264.6	265.0	267.8	272.4	281.0	299.4	331.3	370.2	392.7	431.2
WESTERN DISTRICT:												
Fuel (diesel oil)	401.8	405.4	410.5	413.1	412.1	417.9	436.9	503.6	723.8	833.3	895.5	968.4
Forest products	248.7	250.2	254.8	255.8	265.2	259.9	279.8	288.0	304.2	317.5	357.2	378.4
Iron & steel prod.	227.6	230.6	233.7	238.9	242.8	250.1	260.4	265.3	274.9	283.6	304.9	310.4
Miscellaneous prod.	230.9	233.8	236.2	237.9	238.4	234.9	236.9	240.8	258.5	257.2	268.5	285.8
Total, excl. Fuel	227.2	230.8	233.7	236.5	239.2	244.7	251.6	256.3	266.8	276.8	293.3	306.4
Total, incl. Fuel	278.6	282.5	286.0	288.7	290.5	296.5	305.9	327.3	391.5	436.0	456.2	484.9

Note: Based on prices reported as of first day of months shown.

r - Revised

APPENDIX A-4

3. Quarterly Indexes of Charge-out Price and Wage Rates (Average 1967 = 100)

Districts and Group	Jan. 1976	Apr. 1976	July 1976	Oct. 1976	Jan. 1977	Apr. 1977	July 1977	Oct. 1977	Jan. 1978 [1]	Apr. 1978	July 1978 [1]	Oct. 1978 [1]	Jan. 1979	Apr. 1979	July 1979	Oct. 1979	Jan. 1980	Apr. 1980
UNITED STATES:																		
Fuel	345.6	346.6	347.2	352.6	360.6	381.1	395.2	399.0	403.1	405.9	406.0	407.2	419.7	468.6	540.2	739.9	838.1	846.5
Other materials & supplies	196.6	199.3	202.7	207.6	209.6	213.0	216.5	221.3	224.4	227.0	230.2	233.6	238.1	245.7	250.6	260.2	266.1	273.0
All material incl. fuel	238.2	240.7	243.6	248.5	252.1	260.6	266.5	270.5	274.3	277.0	278.5	280.5	287.5	303.4	327.9	414.6	445.5	454.5
Wage rates	301.7	309.2	312.5	313.0	319.6	320.0	331.5	332.0	340.0	340.2	354.6	359.7	367.5	387.5	393.6	393.6	396.0	396.9
Material prices & wages (excl fuel)	313.1	319.1	322.0	326.7	329.6	332.7	343.2	344.7	351.2	357.2	362.4	366.7	374.9	388.0	394.6	417.6	421.7	429.8
Wages & supplements	333.2	339.9	342.5	343.5	341.6	343.3	353.6	354.9	367.3	372.0	378.1	381.9	394.1	394.1	411.4	411.4	421.4	421.6
Material prices, wages & supplements (excl. fuel)	318.0	323.9	326.9	329.6	335.6	337.6	346.6	348.9	356.9	363.0	368.9	373.6	383.6	394.7	399.9	401.4	421.2	426.2
Material prices, wages & supplements (incl. fuel)	327.3	333.9	335.5	337.6	344.5	347.9	357.3	359.3	368.2	374.0	378.4	382.9	392.9	397.9	420.5	422.4	447.1	453.1
EASTERN DISTRICT:																		
Fuel	350.6	349.1	346.3	351.6	361.4	386.7	405.5	407.6	411.1	416.3	413.4	413.1	423.1	471.3	586.1	713.7	790.9	838.9
Other materials & supplies	191.6	193.5	197.8	202.3	204.4	208.5	210.2	213.6	216.2	217.2	221.5	226.6	230.2	239.6	243.6	252.9	260.6	271.4
All material incl. fuel	235.2	236.5	238.9	243.7	247.7	257.4	263.2	266.6	268.6	272.6	274.1	277.4	283.9	300.9	333.1	376.7	402.6	428.1
Wage rates	293.6	299.7	312.7	313.7	328.1	330.6	339.9	333.9	343.6	349.9	357.7	363.6	378.4	378.4	386.5	388.9	389.9	397.9
Material prices & wages (excl fuel)	318.9	316.9	319.7	321.7	327.5	330.6	339.9	341.8	349.9	358.4	362.1	366.6	373.7	379.4	388.6	413.9	389.0	331.5
Wages & supplements	333.2	338.1	332.4	333.2	343.4	343.9	353.8	355.1	376.3	375.5	383.1	385.9	398.2	398.3	413.7	413.7	335.0	336.7
Material prices, wages & supplements (excl. fuel)	319.1	324.2	326.8	329.2	336.2	338.2	346.8	348.3	361.5	366.3	372.3	376.2	387.2	388.7	403.9	409.5	334.9	337.7
Material prices, wages & supplements (incl. fuel)	329.0	327.6	333.9	335.6	343.6	347.8	355.3	357.9	370.1	374.8	380.2	383.9	394.6	396.6	413.6	419.4	341.2	344.9
SOUTHERN DISTRICT:																		
Fuel	329.7	327.8	319.6	326.1	332.0	350.3	369.5	372.2	375.6	375.3	373.8	374.7	389.1	429.6	548.3	633.7	696.9	747.0
Other materials & supplies	195.7	196.8	198.7	202.6	206.2	209.9	213.2	217.9	220.8	223.3	226.1	229.5	234.7	240.6	246.3	254.6	262.6	273.3
All material incl. fuel	229.1	229.9	230.6	235.0	239.7	249.6	255.6	259.2	261.6	263.0	265.4	268.6	276.8	290.7	316.8	353.2	376.9	407.6
Wage rates	301.5	309.2	314.6	313.9	318.9	319.4	333.6	333.9	339.6	340.9	353.9	360.6	369.3	368.3	386.5	386.5	389.0	393.0
Material prices & wages (excl fuel)	310.9	314.3	319.7	321.1	326.6	329.6	[illegible]	342.1	347.1	354.0	358.9	363.1	370.9	375.5	385.0	389.2	333.6	335.6
Wages & supplements	330.3	333.3	335.1	335.0	341.9	343.0	[illegible]	354.9	365.9	373.5	378.5	382.6	394.3	394.3	411.0	411.0	334.3	336.3
Material prices, wages & supplements (excl. fuel)	318.0	323.8	327.2	329.0	334.2	336.2	347.6	347.7	354.9	362.6	367.2	371.9	381.6	382.7	397.7	399.5	338.9	343.7
Material prices, wages & supplements (incl. fuel)	325.7	328.9	333.0	335.0	341.3	345.0	355.9	356.9	364.6	378.0	376.6	378.3	388.8	393.2	413.3	414.3	340.7	347.6
WESTERN DISTRICT:																		
Fuel	351.1	356.3	358.1	363.6	370.0	387.7	399.6	400.1	409.2	411.5	412.1	416.0	429.1	480.0	588.1	700.6	874.6	944.9
Other materials & supplies	200.2	203.1	206.9	212.6	215.9	218.8	221.6	227.2	229.0	233.7	236.5	239.2	244.7	251.6	256.3	266.6	274.0	283.3
All material incl. fuel	246.0	249.9	251.8	257.5	260.2	268.2	274.6	279.3	283.4	286.2	288.5	291.7	299.2	327.9	354.7	418.5	436.5	468.4
Wage rates	301.0	309.0	313.5	314.0	319.4	320.0	331.9	332.0	340.3	347.1	353.0	357.9	365.8	383.7	383.7	383.7	383.2	383.2
Material prices & wages (excl fuel)	316.3	323.1	325.9	329.7	333.2	336.3	345.1	348.5	356.0	360.2	365.0	369.2	377.1	383.6	392.0	395.6	348.0	351.6
Wages & supplements	333.2	339.7	332.0	333.5	343.7	343.7	353.7	355.4	363.9	371.3	375.6	379.6	391.7	391.7	408.0	409.0	334.6	338.6
Material prices, wages & supplements (excl. fuel)	318.3	326.0	329.6	329.0	335.6	337.6	346.9	348.6	358.6	363.3	367.6	371.0	381.6	382.1	397.7	398.0	339.3	343.3
Material prices, wages & supplements (incl. fuel)	329.6	330.1	327.0	340.6	346.9	350.6	359.7	361.0	371.3	375.7	379.6	383.3	394.0	396.5	325.5	339.1	352.6	363.1

[1] - Wage rates in 1978 reflect the effects of retroactive pay increases applicable to time worked in 1978 but paid in 1979.

APPENIDX A-5

Association of American Railroads
Economics and Finance Department
Washington, D.C. 20036

Series QMPW - 187
April 25, 1980

INDEXES OF RAILROAD MATERIAL PRICES AND WAGE RATES

Railroads of Class I

Division and Group	1967	1968	1969	1970*	1971*	1972	1973	1974	1975*	1976	1977	1978*	1979p
EASTERN DISTRICT													
Fuel	100.0	103.5	106.7	110.5	114.6	117.1	126.0	273.0	321.0	350.1	388.6	486.9	586.6
Other material & supplies	100.0	102.4	105.5	109.2	113.5	118.7	123.0	143.1	169.2	181.2	217.3	279.6	333.2
All material incl. fuel	100.0	102.7	105.8	109.7	113.7	118.1	124.7	179.9	227.2	244.9	283.3	379.5	467.6
Wage rates	100.0	109.1	113.3	122.7	130.0	137.5	144.0	173.6	190.3	210.7	227.3	258.9	279.1
Material prices and wage rates combined	100.0	104.7	110.0	118.2	123.1	129.1	135.3	176.7	211.3	231.3	258.5	322.4	377.9
Work Equipment & Miscellaneous	100.0	104.7	110.0	118.2	123.1	129.1	135.3	176.7	211.3	231.3	258.5	322.4	377.9
Material prices, wage rates & supplements combined (incl. fuel) §	100.0	105.5	110.9	119.0	124.0	130.1	136.4	178.1	213.0	233.2	260.6	325.1	380.9
Material prices, wage rates & supplements combined (incl. fuel) §	100.0	106.9	113.3	123.0	129.7	140.6	163.9	186.9	212.6	238.1	268.6	277.6	313.3
SOUTHERN DISTRICT													
Fuel	100.0	103.2	106.9	109.2	115.3	117.7	127.2	273.6	322.0	350.8	386.7	454.7	561.3
Other material & supplies	100.0	102.7	105.5	109.4	113.2	118.5	122.8	142.5	168.7	180.6	216.6	278.1	331.7
All material incl. fuel	100.0	102.8	105.8	109.6	113.8	118.2	124.6	178.9	226.7	243.7	282.0	377.5	464.1
Wage rates	100.0	109.0	113.3	122.9	130.0	136.8	143.8	173.0	191.3	211.1	228.0	259.5	280.0
Material prices and wage rates combined	100.0	104.6	111.0	118.7	124.0	129.3	135.7	176.0	209.8	230.6	258.0	322.3	378.2
Work Equipment & Miscellaneous	100.0	104.6	111.0	118.7	124.0	129.3	135.7	176.0	209.8	230.6	258.0	322.3	378.2
Material prices, wage rates & supplements combined (incl. fuel) §	100.0	105.4	113.3	123.6	130.3	139.8	167.8	183.9	209.5	237.9	268.3	273.9	309.6
Material prices, wage rates & supplements combined (incl. fuel) §	100.0	106.4	113.3	123.6	134.3	147.4	169.7	189.6	211.7	236.9	267.9	281.7	318.9
WESTERN DISTRICT													
Fuel	100.0	101.6	104.6	106.6	110.9	113.0	120.7	251.1	298.1	322.7	362.5	375.9	524.6
Other material & supplies	100.0	102.0	104.9	108.3	111.9	116.1	121.5	140.3	166.0	179.9	213.4	258.5	317.7
All material incl. fuel	100.0	102.0	104.9	108.2	111.9	116.0	124.1	172.1	217.0	233.7	272.1	326.9	424.9
Wage rates	100.0	104.6	111.6	122.6	130.2	140.1	145.7	172.1	189.9	210.4	226.9	260.0	274.9
Material prices and wage rates combined	100.0	104.1	110.0	118.2	123.4	128.6	135.6	173.3	202.6	224.0	253.1	324.6	378.3
Work Equipment & Miscellaneous	100.0	104.1	110.0	118.2	123.4	128.6	135.6	173.3	202.6	224.0	253.1	324.6	378.3
Material prices, wage rates & supplements combined (incl. fuel) §	100.0	105.0	111.7	122.0	131.0	144.4	166.1	176.0	202.0	233.4	263.0	283.2	299.3
Material prices, wage rates & supplements combined (incl. fuel) §	100.0	105.0	111.7	122.1	130.9	143.1	166.1	183.9	210.0	233.0	262.0	273.1	305.7
NORTH DISTRICT													
Fuel	100.0	103.2	106.1	113.4	110.0	119.7	129.6	291.1	299.9	319.6	366.6	414.0	443.3
Other material & supplies	100.0	102.1	105.9	109.4	114.1	118.1	123.9	141.0	161.1	187.4	215.8	256.7	299.0
All material incl. fuel	100.0	102.7	106.0	110.6	114.7	119.3	129.0	188.9	223.1	242.3	272.3	309.2	361.7
Wage rates	100.0	104.6	111.3	121.7	127.6	140.3	143.7	173.3	190.0	210.0	226.3	260.0	272.9
Material prices and wage rates combined	100.0	104.0	110.6	118.6	123.1	131.7	135.0	173.6	203.3	223.1	251.1	311.1	361.6
Work Equipment & Miscellaneous	100.0	104.0	110.6	118.6	123.1	131.7	135.0	173.6	203.3	223.1	251.1	311.1	361.6
Material prices, wage rates & supplements combined (incl. fuel) §	100.0	105.1	111.8	122.6	130.9	147.3	165.1	189.6	206.1	236.6	263.3	264.7	299.0
Material prices, wage rates & supplements combined (incl. fuel) §	100.0	105.1	111.8	122.8	134.4	148.5	163.6	187.0	213.6	239.3	266.3	277.3	313.3

§ - Includes payroll taxes, health and welfare benefits and other allowances.

* - Wage indexes for 1970, 1971, 1975 and 1978 include retroactive wage increases paid in 1971, 1972, 1976 and 1979 respectively.

p - Wage rates and wages and supplements indexes, and combinations including them, are preliminary. Indexes for fuel and materials and supplies are final.

Form MS - 74

(Railroads included)

PURCHASES OF FUEL, MATERIAL AND SUPPLIES
CALENDAR YEAR 1974

Item and AAR Standard Material Classification Number	Total cost
FUEL:	
1. Fuel, Diesel and residual fuel oil (Class 39)	
2. All other fuel	
3. Total fuel	
FOREST PRODUCTS:	
4. Cross ties, wooden (Class 5)	
5. Switch ties, wooden (Class 5)	
6. All other forest products	
7. Total forest products	
IRON AND STEEL PRODUCTS:	
8. Rail (new and second hand except scrap) (Class 8)	
9. Axles and wheels for cars and locomotives (Class 29)	
10. Track and switch material (Class 1)	
11. Iron and steel (bars, shapes, sheet, tubing, chain and wire)(Class 15)	
12. Locomotive and car forgings, castings, and specialties, and bolts, nuts, washers, rivets, screws, pins and studs (Classes 11, 19 and 20)	
13. Springs for cars and locomotives (Class 12)	
14. Pipe, iron and steel, fittings, and plumbing fixtures (Class 43)	
15. Track and roadway tools, small hand and machine tools, and parts (Classes 10 and 45)	
16. All other iron and steel products	
17. Total iron and steel products	

Form MS - 74

Item and AAR Standard Material Classification Number	Total cost
MISCELLANEOUS PRODUCTS:	
18. Building materials (brick, cement, gravel, lime, sand, stone, roofing, siding, fencing, cast iron water pipe and culvert pipe) (Class 3)	
19. Lubricating oil and greases (Class 27)	
20. Non-ferrous metal and products (Class 21)	
21. Ballast and riprap (Class 7)	
22. Electrical materials (excluding electrical material for Diesel locomotives) (Class 23)	
23. Stationery, printing and office supplies (Class 48)	
24. Chemicals, compounds, drugs, glass, laboratory equipment, paints, lacquers, varnishes and painters, supplies (Class 47)	
25. Locomotive, train and station supplies (Class 29)	
26. Communication and signal material (Class 2)	
27. Air brake material (including air brake hose) (Class 22)	
28. Automotive vehicles, aircraft and parts (Class 10)	
29. Diesel locomotive material, (including electrical) (Classes 23 and 24)	
30. All other miscellaneous products	
31. Total miscellaneous products	
32. Total purchases of fuel, material and supplies	

Signature _____

Title _____

Date _____

To be returned by March 1, 1973
ASSOCIATION OF AMERICAN RAILROADS
Economics and Finance Department
American Railroads Building
Washington, D. C. 20036

APPENIDX B

The following accounts are used in creating the ICC Composite Index for durable assets:

1 Engineering
3 Grading
4 Other Right-Of-Way Expenditures
5 Tunnels and Subways
6 Bridges, Trestles, and Culverts
7 Elevated Structures
8 Ties
9 Rail
10 OtherTrack Material
11 Ballast
12 Track Laying and Surfacing
13 Fences, Snow Sheds, and Signs
16 Station and Office Buildings
17 Roadway Buildings
18 Water Stations
19 Fuel Stations
20 Shops and Enginehouses
21 Grain Elevators
22 Storage Warehouses
23 Wharves and Docks
24 Coal and Ore Wharves
25 TOFC/COFC Terminals
26 Communication System
27 Signals and Interlockers
29 Power Plants
31 Power-Transmission Systems
35 Miscellaneous Structures
37 Roadway Machines
38 Roadway Small Tools
39 Public Improvements-Construction
44 Shop Machinery
45 Power-Plant Machinery
52 Locomotives
53 Freight-Train Cars
54 Passenger-Tain Cars
55 Highway Revenue Equipment
56 Flating Equipment
57 Work Equipment
58 Miscellaneous Equipment

§ 10707a. Zone of rail carrier rate flexibility

(a) In this section—

(1)(A) "base rate" means, with respect to the transportation of a particular commodity (i) for the 24-month period beginning on October 1, 1980, the rate in effect on October 1, 1980, (ii) for the 24-month period beginning on October 1, 1982, the rate in effect on October 1, 1982, and (iii) for the 5-year period beginning on October 1, 1984, and for each subsequent 5-year period, the rate in effect on the first day of the applicable 5-year period.

(B) If no rate exists for the transportation of a particular commodity on October 1, 1980, the base rate for the transportation of such commodity shall be the rate established by the rail carrier (divided by the latest rail cost adjustment factor published by the Commission), unless such rate is found to be unreasonable by the Commission, in which case the base rate shall be the rate authorized by the Commission (divided by the latest rail cost adjustment factor published by the Commission).

(2)(A) "adjusted base rate" means the base rate for the transportation of a particular commodity multiplied by the latest rail cost adjustment factor published by the Commission pursuant to this paragraph.

(B) Commencing with the fourth quarter of 1980, the Commission shall, as often as practicable but in no event less often than quarterly, publish a rail cost adjustment factor which shall be a fraction, the numerator of which is the latest published Index of Railroad Costs (which index shall be compiled or verified by the Commission, with appropriate adjustments to reflect the changing composition of railroad costs, including the quality and mix of material and labor), and the denominator of which is the same index for the fourth quarter of 1980, or for the fourth quarter of 1982 or for the fourth quarter of every fifth year thereafter, as appropriate.

(b)(1) Except as provided in paragraph (2) of this subsection, a rail carrier providing transportation subject to the jurisdiction of the Interstate Commerce Commission under subchapter I of chapter 105 of this title may increase any rate over which the Commission has jurisdiction under section 10709 of this title so long as the increased rate is not greater than the adjusted base rate for the transportation involved, plus any rate increases implemented under subsection (c) or (d) of this section.

(2) A rate increase authorized under this subsection may not be found to exceed a reasonable maximum for the transportation involved.

(3) A rail carrier may not increase a rate under this subsection to the extent that the cost increases to such carrier due to inflation are recovered through (A) general rate increases pursuant to section 10706 of this title, or (B) inflation-based rate increases under section 10712 of this title applicable to that rate.

(c)(1) During the 12-month period beginning on the effective date of the Staggers Rail Act of 1980 and during each of the 3 succeeding 12-month periods, a rail carrier may, in addition to rate increases

authorized under subsection (b) of this section, increase any rate over which the Commission has jurisdiction under section 10709 of this title by an annual amount of not more than 6 percent of the adjusted base rate, except that in no event shall the total increase under this subsection result in a rate which is more than 118 percent of the adjusted base rate.

(2)(A) If any portion of a rate increase under this subsection is not implemented in the year in which it is authorized, such portion may, except as provided in subparagraph (B) of this paragraph, be implemented only in the next succeeding year.

(B) If any portion of the total rate increase authorized under this subsection is not implemented by the end of the 4-year period beginning on the effective date of the Staggers Rail Act of 1980, such portion may be implemented in the next 2 succeeding years, except that in no event may a rail carrier increase a rate under this subsection or under subsection (d) of this section in either of such 2 succeeding years by an annual amount of more than 10 percent of the adjusted base rate.

(d)(1) Except as provided in paragraph (3) of this subsection, during the 12-month period beginning on October 1, 1984, and during each succeeding 12-month period, a rail carrier may, in addition to rate increases under subsection (b) of this section, increase any rate over which the Commission has jurisdiction under section 10709 of this title by an annual amount of not more than 4 percent of the adjusted base rate.

(2) No portion of any rate increase under this subsection which is not implemented in the year in which it is authorized may be implemented in any other year.

(3)(A) The provisions of this subsection shall not apply to a rail carrier proposing to increase a single line rate if such carrier earns adequate revenues, as determined by the Commission under section 10704(a)(2) of this title.

(B) The Commission shall, after a hearing on the record, prescribe such rules with respect to joint rates as necessary to ensure that rail carriers which earn adequate revenues, as determined under section 10704(a)(2) of this title, do not receive the rate increases authorized by this subsection unless the Commission determines that it is unable to prescribe such rules without precluding rail carriers not earning adequate revenues from receiving the rate increases authorized under this subsection.

(e)(1) Notwithstanding the provisions of section 10707 of this

title, in the case of any rate increase by a rail carrier that is authorized under subsection (c) or (d) of this section—

(A)(i) the Commission may not suspend such rate increase pending final Commission action; and

(ii) except as provided in paragraph (2) of this subsection, the Commission may not begin an investigation proceeding under section 10707 of this title with respect to the reasonableness of such rate increase; but

(B) an interested party may file a complaint under section 11701(b) of this title alleging that such rate increase violates the provisions of this subtitle.

In considering any complaint challenging a rate increase that is authorized under subsection (c) of this section and that results in a revenue-variable cost percentage that is less than the lesser of the percentages described in clauses (i) and (ii) of paragraph (2)(A), the Commission shall, in determining the reasonableness of such rate increase, give due consideration to whether the carrier proposing the rate increase has attained adequate revenues, as determined by the Commission under section 10704(a)(2) of this title, giving regard to preventing a carrier with adequate revenues from realizing excessive profits on the traffic involved and also the policy of bringing to an adequate level the revenues of carriers not having an adequate revenue level.

(2)(A) If a rate increase authorized under this section in any year results in a revenue-variable cost percentage for the transportation to which the rate applies that is equal to or greater than—

(i) 20 percentage points above the revenue-variable cost percentage applicable in that year under section 10709(d) of this title; or

(ii) a revenue-variable cost percentage of 190 percent,

whichever is less, the Commission may, on its own initiative, or on complaint of an interested party, begin an investigation proceeding to determine whether the proposed rate increase violates this subtitle.

(B) In determining whether to investigate or not to investigate any proposed rate increase that results in a revenue-variable cost percentage for the transportation to which the rate applies that is equal to or greater than the lesser of the percentages described in clauses (i) and (ii) of subparagraph (A) of this paragraph (without regard to whether such rate increase is authorized under this section), the Commission shall set forth its reasons therefor, giving due consideration to the following factors:

(i) the amount of traffic which is transported at revenues which do not contribute to going concern value and efforts made to minimize such traffic;

(ii) the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and

(iii) the impact of the proposed rate or rate increase on the attainment of the national energy goals and the rail transportation policy under section 10101a of this title, taking into account the railroads' role as a primary source of energy transportation and the need for a sound rail transportation system in accordance with the revenue adequacy goals of section 10704 of this title.

This subparagraph shall not be construed to change existing law with regard to the nonreviewability of such determination.

(C) In determining whether a rate is reasonable, the Commission shall consider, among other factors, evidence of the following:

(i) the amount of traffic which is transported at revenues which do not contribute to going concern value and efforts made to minimize such traffic;

(ii) the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and

(iii) the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues.

(f) In any proceeding under this section, evidence of the underlying rail carrier rate is admissible.

(g) A finding by the Commission that a rate increase exceeds the increase authorized under this section does not establish a presumption that (1) the rail carrier proposing such rate increase has or does not have market dominance over the transportation to which the rate applies, or (2) the proposed rate exceeds or does not exceed a reasonable maximum.

(h) The authority of the Commission to determine and prescribe reasonable rules, classifications, and practices may not be used, directly or indirectly, to limit the rates which rail carriers are otherwize authorized to establish under this subtitle.

Added Pub.L. 96-448, Title II, § 203(a), Oct. 14, 1980, 94 Stat. 1901.

§ 10709. Determination of market dominance in rail carrier rate proceedings

(a) In this section, "market dominance" means an absence of effective competition from other carriers or modes of transportation for the transportation to which a rate applies.

(b) When a rate for transportation by a rail carrier providing transportation subject to the jurisdiction of the Interstate Commerce Commission under subchapter I of chapter 105 of this title is challenged as being unreasonably high, the Commission shall determine, within 90 days after the start of a proceeding under section 10707 of this title to investigate the lawfulness of that rate, whether the carrier proposing the rate has market dominance over the transportation to which the rate applies. The Commission may make that determination on its own initiative or on complaint. A finding by the Commission that the carrier does not have market dominance is determinative in a proceeding under this subtitle related to that rate or transportation unless changed or set aside by the Commission or set aside by a court of competent jurisdiction.

(c) When the Commission finds in any proceeding that a rail carrier proposing or defending a rate for transportation has market dominance over the transportation to which the rate applies, it may then determine that rate to be unreasonable if it exceeds a reasonable maximum for that transportation. However, a finding of market dominance does not establish a presumption that the proposed rate exceeds a reasonable maximum. This subsection does not limit the power of the Commission to suspend a rate under section 10707(c) of this title. However, if the Commission has found that a carrier does not have market dominance over the transportation to which the rate applies, the Commission may suspend an increase in that rate as being in excess of a reasonable maximum for that transportation only if it specifically changes or sets aside its prior determination of market dominance.

(d)(1) In this subsection—

(A) "fixed and variable cost" means all cost incurred by rail carriers in the transportation of freight, but limiting the return on equity capital to a rate equal to the embedded cost of debt.

(B)(i) "cost recovery percentage" means the lowest revenue-variable cost percentage which, if all movements that produced revenues resulting in revenue-variable cost percentages in excess of the cost recovery percentage are deemed to have produced only revenues resulting in the cost recovery percentage, would produce revenues which would be equal, when combined with total revenues produced by all other traffic transported by rail carrier, to the total fixed and variable cost of the transportation of all traffic by rail carrier.

(ii) for purposes of determining the cost recovery percentage only, "revenue-variable cost percentage" means the quotient, expressed as a percentage figure, obtained by dividing the total revenues produced by the transportation of all traffic received by rail carriers for rail transportation by the total variable cost of such transportation.

(2) In making a determination under this section, the Commission shall find that the rail carrier establishing the challenged rate does not have market dominance over the transportation to which the rate applies if such rail carrier proves that the rate charged results in a revenue-variable cost percentage for such transportation that is less than—

(A) 160 percent during the period beginning on the effective date of the Staggers Rail Act of 1980 and ending September 30, 1981;

(B) 165 percent during the period beginning October 1, 1981, and ending September 30, 1982;

(C) 170 percent during the period beginning October 1, 1982, and ending September 30, 1983;

(D) 175 percent or the cost recovery percentage, whichever is less, during the period beginning October 1, 1983, and ending September 30, 1984; and

(E) the cost recovery percentage, during each 12-month period beginning on or after October 1, 1984.

For purposes of subparagraphs (D) and (E) of this paragraph, the cost recovery percentage shall in no event be less than a revenue-variable cost percentage of 170 percent or more than a revenue-variable cost percentage of 180 percent.

(3) For purposes of determining the revenue-variable cost percentage for a particular transportation, variable costs shall be determined pursuant to section 10705a(m)(1) of this title, with adjustments specified by the Commission. A rail carrier may meet its burden of proof under th subsection by establishing its variable costs in accordance witl uch section 10705a(m)(1), but a shipper may rebut that showing by evidence of such type, and in accordance with such burden of proof, as the Commission shall prescribe.

(4) A finding by the Commission that a rate charged by a rail carrier results in a revenue-variable cost percentage for the transportation to which the rate applies that is equal to or greater than the

applicable percentage under paragraph (2) of this subsection does not establish a presumption that (A) such rail carrier has or does not have market dominance over such transportation, or (B) the proposed rate exceeds or does not exceed a reasonable maximum.

(5)(A) Within 180 days after the effective date of the Staggers Rail Act of 1980 and on an annual basis thereafter, the Commission shall determine the cost recovery percentage for the transportation of all traffic received by rail carriers. The Commission shall make such determination after considering each individual revenue-variable cost percentage resulting from the revenues and costs of a valid and reliable statistical sample of all movements of commodities transported by class I rail carriers during the most recent calendar year for which such information is available.

(B) If, on the basis of calculations under subparagraph (A) of this paragraph, the Commission determines that revenues earned by all class I rail carriers during the previous calendar year do not exceed the fixed and variable costs of such carriers, then the cost-recovery percentage for purposes of this section shall be deemed to be equal to the cost recovery percentage last determined by the Commission.

(C) The Commission shall, in its annual report submitted to the Congress under section 10311 of this title, set forth the cost recovery percentage determined for that year under subparagraph (A) of this paragraph.

Pub.L. 95–473, Oct. 17, 1978, 92 Stat. 1382; Pub.L. 96–448, Title II, § 202, Oct. 14, 1980, 94 Stat. 1900.

INTERSTATE COMMERCE COMMISSION
Ex Parte No. 290 (Sub. No. 4)

RAILROAD COST RECOVERY PROCEDURES
PRODUCTIVITY ADJUSTMENT
(49 CFR 1102)

AGENCY: Interstate Commerce Commission
ACTION: Advance Notice of Proposed Rulemaking

SUMMARY: The Commission is instituting this proceeding to request comments on the use of a productivity adjustment in determining the quarterly rail cost adjustment factor and proposals for measuring productivity and for implementing a productivity adjustment. The Commission's reconsideration in this matter is being made in light of the D.C. Circuit's recent decision which anticipated that the Commission would eventualy reconsider the productivity adjustment issue. These comments will be considered separately from the comments requested in the Commission's recent Advance Notice of Proposed Rulemaking in Ex Parte No. 290 (Sub-No. 2), *Railroad Cost Recovery Procedures,* 47 Fed. Reg. 18012 (April 27, 1982).

DATES: Comments are due 45 days from publication of this notice in the Federal Register.

ADDRESS: Send an original and, if possible, 15 copies of comments to:

Room 5340
Interstate Commerce Commission
Washington, DC 20423

FOR FURTHER INFORMATION CONTACT:

Leslie J. Selzer
(202) 275-7627
or
William T. Bono
(202) 275-7354

SUPPLEMENTARY INFORMATION:

In an Advance Notice of Proposed Rulemaking published at 47 Fed. Reg. 18012 (April 27, 1982), the Commission reopened the Ex Parte No. 290 (Sub-No. 2) proceeding to request comments on a wide range of issues. The Commission discussed these issues in detail in a separate decision served April 27, 1982. In footnote 2 to that decision, the Commission stated that the scope of the reopening would exclude those issues on judicial review before the United States Court of Appeals for the District of Columbia Circuit in No. 81-1437, *Western Coal Traffic League* v. *United States.* This was intended to avoid interference with the court's review of the Commission's decision in Ex Parte No. 290 (Sub-No. 2), *Railroad Cost Recovery Procedures,* 364 I.C.C. 841 (1981).

On May 4, 1982, the court issued its decision in No. 81-1437, affirming the Commission's 1981 decision. The court concluded:

> We expect, however, that in accordance with its stated intentions, the Commission will continuously review the accuracy of its chosen index and will revise the index in an appropriate fashion, including consideration of measurable productivity gains, as the circumstances warrant. (Sheet 36)

On May 5, 1982, the Western Coal Traffic League filed a petition to broaden the reopened proceedings to include the productivity adjustment issue. The railroads filed a reply on May 25, 1982.

Inclusion of this issue in Ex Parte No. 290 (Sub-No. 2) at this time would unduly delay the Commission's consideration of the issues discussed in the April 27, 1982, decision. Therefore, we deny the Western Coal Traffic League's petition to broaden the April 27, 1982, reopening to include the productivity adjustment issue. Comments directed to the April 27 notice and decision were due on July 9, 1982. See 47 Fed. Reg. 25035 (June 9, 1982).

The D.C. Circuit's recent decision, however, expressly anticipated that the Commission would consider the productivity adjustment issue. Accordingly, we are instituting this proceeding to request comments on the possible use of the productivity adjustment in determining the quarterly rail cost adjustment factor and proposals for measuring productivity and for implementing a productivity adjustment. These comments should be submitted, and will be considered, separately from the comments directed to the April 27, 1982, notice and decision in Ex parte No. 290 (Sub-No. 2).

Comments directed to the productivity adjustment issues are due 45 days from the publication of this notice in the Federal Register.

Finally, we will address the requirements of the Regulatory Flexibility Act, 5 U.S.C. §601 *et seq.*, in the Notice of Proposed Rulemaking, should one result here.

The list of subjects in 49 CFR Part 1102: Railroads, freight.

This notice is issued under the authority of 49 U.S.C. 10321 and 10707a, and 5 U.S.C. 553 and 559.

Dated: July 14, 1982.

By the Commission, Chairman Taylor, Vice Chairman Gilliam, Commissioners Sterrett, Andre, Simmons, and

Gradison. Commissioner Andre dissented with a separate expression.

Agatha L. Mergenovich
Secretary

(SEAL)

Commissioner Andre, dissenting:

The productivity issue should be joined with the issues in Ex Parte No. 290 (Sub-No. 2).

Office - Supreme Court, U.S.
FILED
NOV 27 1982
ALEXANDER L. STEVAS,
CLERK

No. 82-435

In the Supreme Court of the United States

OCTOBER TERM, 1982

COMMONWEALTH EDISON COMPANY, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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Washington, D.C. 20423

QUESTION PRESENTED

Whether the decision of the Interstate Commerce Commission not to include a productivity adjustment in its initial formulation of the Index of Railroad Costs, adopted pursuant to Section 203(a)(a)(2)(B) of the Staggers Rail Act of 1980, 49 U.S.C. (Supp. IV) 10707a(a)(2)(B), was consistent with the statute and a reasonable exercise of discretion.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	1
Argument	6
Conclusion	8

TABLE OF AUTHORITIES

Statutes:

Staggers Rail Act, Pub. L. No. 96-448, 94 Stat. 1895, (codified in scattered sections of 11, 45 and 49 U.S.C. (Supp. IV)) 1-2

Section 2, 94 Stat. 1896 6
Section 201(a), 49 U.S.C. (Supp. IV) 10701a(a) 2
Section 201(a)(b)(1), 49 U.S.C. (Supp. IV) 10701(a)(b)(1) 2
Section 203(a), 49 U.S.C. (Supp. IV) 10707a 2, 5, 6
Section 203(a)(2)(A), 49 U.S.C. (Supp. IV) 10707a(a)(2)(A) 2
Section 203(a)(2)(B), 49 U.S.C. 10707a(a)(2)(B) 2

Miscellaneous:

H.R. Rep. No. 96-1036, 96th Cong., 2d Sess. (1980) 6

364 I.C.C. 841 (1981) 7

Notice of Proposed Rulemaking in Ex Parte No. 290 (Sub-No. 2), 45 Fed. Reg. 81218 (1980) 3, 7

In the Supreme Court of the United States

OCTOBER TERM, 1982

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UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A-1 to A-36) is reported at 677 F.2d 915. The decision of the Interstate Commerce Commission (Pet. App. C-1 to C-33) adopting its final rule is reported at 364 I.C.C. 841.

JURISDICTION

The judgment of the court of appeals was entered on May 4, 1982. A petition for rehearing was denied on June 15, 1982 (Pet. App. B-1). The petition for a writ of certiorari was filed on September 13, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1980, in an effort to streamline the administrative process accompanying rate increases for railroads, Congress passed the Staggers Rail Act, Pub. L. No. 96-448, 94

Stat. 1895 (codified in scattered sections of 11, 45, and 49 U.S.C. (Supp. IV)), which modified the authority of the Interstate Commerce Commission to review rate increases. Of particular concern to this case is Section 203(a) of the Act, 49 U.S.C. (Supp. IV) 10707a, which immunized certain rate increases from Commission review in order to allow the railroads to recover fully inflation-caused cost increases.

Section 203(a) provides for a complex set of formulations in order to determine whether a particular rate is subject to any ICC review. Thus, the new section permits regulated railroads[1] to raise their rates without any ICC review, so long as the increased rate does not exceed an "adjusted base rate" for the transportation involved. The statute defines an "adjusted base rate" as the "base rate" for a commodity's movement (generally, the rate in effect on a date specified) multiplied by a cost adjustment factor published quarterly by the Commission, 49 U.S.C. (Supp. IV) 10707a(a)(2)(A). The cost adjustment factor, in turn, is defined in 49 U.S.C. 10707a(a)(2)(B), as:

> a fraction, the numerator of which is the latest published Index of Railroad Costs (which index shall be compiled or verified by the Commission, with appropriate adjustments to reflect the changing composition of railroad costs, including the quality and mix of material and labor), and the denominator of which is the same index for the fourth quarter of 1980, or for the fourth quarter of 1982 or for the fourth quarter of every fifth year thereafter, as appropriate.

In sum, the statute requires the Commission to establish an index of costs and revise it periodically to reflect inflation; that index is then included in the cost adjustment factor

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[1]The Commission only has jurisdiction over rates set by carriers that are not subject to effective competition from other carriers, i.e., market dominant carriers. 49 U.S.C. (Supp. IV) 10701a(a), and 10701a (b)(1).

which in turn establishes the maximum to which the railroad can increase its rates without being subject to any reasonableness inquiry.

2. To implement this new section, the Commission issued a Notice of Proposed Rulemaking in Ex Parte No. 290 (Sub-No. 2), 45 Fed. Reg. 81217 (1980) and proposed to adopt as the Index of Railroad Costs a modified version of the input price index developed and used by the Association of American Railroads (AAR). The AAR index was designed to measure increases in the prices of fuel, materials and labor purchased by railroads.[2]

The Commission's Notice discussed the differences between input price indexes and output cost indexes.[3] An input price index measures inflation's effect on the prices railroads pay for the goods and services they consume to produce transportation service. In contrast, an output cost index measures inflation's effect on the costs per unit of railroad output. The difference is that an output cost index takes into account factors such as productivity, traffic mix, and traffic volume, all of which affect how much it costs a railroad to produce a unit of transportation. The Commission proposed not adjusting the AAR index to reflect productivity.

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[2]Construction of the AAR index begins with selection by purchasing officers from ten representative railroads of a market basket containing 65 items that are representative of the railroad industry's materials purchases. The materials index is then combined with a wage index to produce a final weighted index reflecting the mix of materials and labor in total railroad costs. Periodically, the AAR updates the index to reflect changes in the market basket's composition, and changes in the mix of material and labor.

[3]Because the AAR index measured only 72 percent of rail costs, however, the Commission proposed to use the Bureau of Labor Statistics' Producers Price Index (PPI) to measure the other 28 percent of rail costs until the AAR index becomes all-inclusive. The PPI measures average prices paid to producers of commodities.

In April 1981, the Commission adopted the index proposed in its prior Notice, and explained its decision not to adjust the AAR index to reflect productivity (Pet. App. C-1 to C-33). The Commission found that because Section 203(b) of the Staggers Rail Act of 1980 does not specify whether an input price or output cost index should be used for the railroad cost adjustment factor, the Commission could make that decision as a matter of policy (Pet. App. C-6). The Commission acknowledged that productivity adjustments are theoretically possible, but it also noted that the methodological problems involved in such measures are "grave," and concluded that it would be inappropriate to adjust the AAR index for productivity as long as the railroads are not earning adequate revenues (*ibid.*). In the Commission's view, forcing railroads to give up productivity gains in the face of inadequate revenues would tend to perpetuate an investment climate in which railroads would have difficulty attracting capital (*ibid.*). The Commission also noted that an industry average productivity adjustment might unfairly penalize carriers who, for reasons beyond their control, are unable to achieve the average increase in productivity (*id.* at C-7).

3. The court of appeals affirmed (Pet. App. A-1 to A-36). The court first concluded that the statutory language referring to the Railroad Cost Index was ambiguous and that the history of the statute did not disclose clearly whether Congress intended for the index to be based on inputs or outputs (*id.* at A-13 to A-22). The court then considered the purpose of Section 203 and held that it was designed primarily to allow railroads to recover cost increases. The court also concluded that a secondary goal of the statute is to provide expeditious rate increases (Pet. App. A-25). Finding that an output index would be cumbersome and potentially unreliable, the court held (*ibid.*):

> [W]e cannot conclude that this [cost recovery] purpose mandates adoption of an output index regardless of the accuracy of such an index or the feasibility of designing it so as to allow railroads to obtain rate increases in a timely manner.

The court of appeals then considered whether the Commission acted reasonably in deciding on the basis of the rulemaking proceeding not to adjust the AAR index for productivity changes. Noting the Commission's intention to check periodically its current methodology against other data sources, and the Commission's willingness to consider making a productivity adjustment at some later date (Pet. App. A-27),[4] the court narrowed its concern to "whether the Commission has adequately supported its decision to omit [a productivity] adjustment *at this time*" (*ibid.*; emphasis in original). The court found that the Commission's primary reason for using an input index was that available productivity measures are too unreliable and the consequences of overestimating productivity growth too severe to permit an adjustment based on an assumption of continued productivity growth (Pet. App. A-28). Finding support for this rationale in the record (*id.* at A-28 to A-29), the court held that the Commission's initial decision to risk error on the side of cost recovery was reasonable (*id.* at A-31).[5]

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[4]Two months after the court of appeals issued its decision, the Commission responded to the court's opinion and to requests by shippers and opened a rulemaking proceeding in Ex Parte No. 290 (Sub-No. 4), *Railroad Cost Recovery Procedures—Productivity Adjustment* (Pet. App. E-1 to E-4). The purpose of that proceeding is to determine whether the cost recovery index should be adjusted to reflect productivity.

[5]The court also analyzed and found unpersuasive the Commission's three remaining policy reasons for omitting a productivity adjustment. These additional reasons were (1) that an adjustment would unduly penalize railroads with below average productivity performance (Pet. App. A-32 to A-33); (2) that even under competitive conditions businesses do not pass along productivity increases when their revenues are

ARGUMENT

1. Petitioners contend (Pet. 6-9) that the court of appeals erroneously held that Section 203 does not mandate use of an "output" methodology in its Index of Railroad Costs. Petitioners claim (Pet. 6-7) that since Section 203's purpose is cost recovery and not revenue enhancement, the statute simply precludes an input index that omits an adjustment for productivity increases to reflect more accurately the actual effects of inflation. The court of appeals correctly rejected this contention (Pet. App. A-23, A-25).

The practical objective of Section 203's cost recovery index was to assure that railroad rates actually reflect current costs (Pet. App. A-23). Because [theoretically sound] "output" methodology could in practice leave railroads without full inflation compensation if no reliable and quick way to measure productivity exists, the court properly concluded that the statute did not absolutely require an output index. This holding is consistent with the Staggers Rail Act's findings that railroad revenue inadequacy is attributable in large measure to the inability of railroads in the past to keep their rates even with inflation. See Pub. L. No. 96-448, Section 2, 94 Stat. 1896; H.R. Rep. No. 96-1036, 96th Cong., 2d Sess. 95-96 (1980). Because an inaccurate or time-consuming productivity adjustment could prevent railroads from recovering fully the effects of inflation, the court of appeals correctly interpreted Section 203 as not requiring an "output" index, if immediate use of that methodology would keep the railroads in the unsatisfactory revenue position the Act was adopted to remedy. In light of the ambiguity in the statutory language and the legislative

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inadequate (*id.* at A-33 to A-34); and (3) that an adjustment would undermine incentives for productivity improvement (*id.* at A-34 to A-35).

history, the reasonable decision of the court of appeals that the policy of this complex Act could be furthered by the Commission's "input" index does not warrant review by this Court.

2. Petitioners argue (Pet. 7) that the Commission failed to explain adequately its decision to rely solely on an input index and that the court of appeals therefore was required to affirm the administrative decision on a basis not advanced by the agency. Petitioners' contention ignores the specific finding by the court of appeals (Pet. App. A-28) that

> [t]he crux of the Commission's rationale is that available productivity measures are sufficiently unreliable, and the consequences of overestimating productivity growth are sufficiently grave, that it is inappropriate to adjust the cost index on the assumption of continued productivity growth. The Commission's assessment of the unreliability of productivity measures finds support in the record.

The court of appeals correctly found that although the Commission cited several reasons for its rule the existence of substantial doubt about the reliability of any productivity measures was a significant reason why the Commission decided to adopt an input index.[6] Moreover, the court of appeals examined the record and found support for the

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[6]The Notice of Proposed Rulemaking stated (45 Fed. Reg. 81218 (1980)): "[F]or a number of reasons, we think a productivity adjustment would be impossible at this time, and would not significantly change the index figures. First, * * * there is no acceptable measure of productivity available." In adopting the final rule, the Commission said (364 I.C.C. 841, 846 (1981)): "On further consideration, we now conclude that methodological problems of productivity measurement alone (although grave) do not preclude the development of productivity measures. We nevertheless question the reliability of such measures and as a matter of policy do not believe that their use is justified."

Commission's finding that such measures may not be reliable (Pet. App. A-28 to A-30). Thus, the court confined its review to the agency's articulated rationale in deciding that the Commission's initial formulation of a cost index that relied solely on inputs was reasonable.[7]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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Solicitor General

JOHN BROADLEY
General Counsel

KATHLEEN M. DOLLAR
Associate General Counsel

LAWRENCE H. RICHMOND
Deputy Associate General Counsel
Interstate Commerce Commission

NOVEMBER 1982

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[7]Petitioners assert (Pet. 9-11) that the discrepancy between actual inflation and the recovery allowed by the Commission's rule will subject shippers to huge and unchallengeable rate increases over the next ten years. This hypothetical argument is baseless. The Commission is now reexamining the productivity issue. See note 4, *supra*, and thus petitioners' concerns are being fully protected in an ongoing administrative proceeding. There is no reason for this Court to intervene on this issue at this time.

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No. 82-435

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

COMMONWEALTH EDISON COMPANY, ET AL.,
Petitioners,

v.

UNITED STATES OF AMERICA and
INTERSTATE COMMERCE COMMISSION, ET AL.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF IN OPPOSITION FOR THE RESPONDENT ASSOCIATION OF AMERICAN RAILROADS

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October 13, 1982

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

As part of the Staggers Rail Act of 1980, Congress created a "zone of rate flexibility" which was intended to enable railroads to respond to inflationary cost increases through immediate rate adjustments. In Section 203 of the Staggers Act, 49 U.S.C. § 10707a, Congress provided that (with certain specific exceptions) a railroad "may increase any rate" so long as "the increased rate is not greater than the adjusted base rate for the transportation involved." The "adjusted base rate" was defined to be the "base rate" in effect at a stated time, "multiplied by the latest rail cost adjustment factor" published by the Interstate Commerce Commission. Pursuant to Section 203, the Commission conducted a proceeding and issued a decision adopting procedures for quarterly publication of the Index of Railroad Costs to be used in developing the quarterly rail cost adjustment factor. In its decision the Commission decided not to require productivity adjustments in determining the rail cost adjustment factor because of the unreliability of productivity measures and the risk of overdeflating the cost index at a time when railroads are suffering from revenue inadequacy.

The Court of Appeals affirmed, holding that the Commission was not required by Section 203 to impose productivity adjustments on the cost index, and that the Commission had not abused its discretion in deciding not to do so. The court added that it expected the Commission, in accordance with its stated intentions, to continue to review the accuracy of the index, and to consider possible adjustments to reflect productivity gains. Following the court's decision, the Commission initiated a special rulemaking proceeding, Ex Parte No. 290 (Sub-No. 4), in which it is now considering the possible use of a productivity adjustment in determining the rail cost adjustment factor.

The issues which Petitioners ask this Court to review are primarily *factual* issues. They are:

1. Whether the index of railroad costs adopted by the Commission, in the decision affirmed by the Court of Appeals, substantially overstates actual railroad cost increases; and

2. Whether, therefore, the Commission acted arbitrarily or abused its discretion in declining to include a productivity adjustment as part of the rail cost recovery procedure.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF AUTHORITIES	iv
STATEMENT OF CASE	2
A. Background of the Staggers Rail Act of 1980	2
B. Section 208 of The Staggers Act	3
C. Proceedings Before the Commission	6
D. The Decision of the Court of Appeals	8
E. Further Proceedings Before the Commission	11
ARGUMENT	11
CONCLUSION	17

TABLE OF AUTHORITIES

Cases Page

Western Coal Traffic League v. *United States*, 677 F.2d 915 (D.C. Cir. 1982) 8-11, 13, 15

Administrative Proceedings

Ex Parte No. 290 (Sub-No. 2), *Procedure Governing General Rate Increase Proceedings; Railroad Cost Recovery Procedures*, 45 Fed. Reg. 81217 (December 10, 1980) 6, 7, 14

Ex Parte No. 290 (Sub-No. 2), *Procedure Governing General Rate Increase Proceedings; Railroad Cost Recovery Procedures*, 364 I.C.C. 841 (1981) 7, 8, 13, 14, 15

Ex Parte No. 290 (Sub-No. 4), *Railroad Cost Recovery Procedures—Productivity Adjustment*, 47 Fed. Reg. 32176 (1982) 2, 11, 16

Statutes and Regulations

Staggers Rail Act of 1980:
Section 203; 49 U.S.C. § 10707a ..... *passim*

Interstate Commerce Act:
49 U.S.C. § 11701(b) 5
49 C.F.R. § 1102 3

Legislative History

H.R. Rep. No. 96-1035, 96th Cong., 2d Sess. (1980) 2

H.R. Rep. No. 96-1430, 96th Cong., 2d Sess. (1980) 5, 6

S. Rep. No. 96-470, 96th Cong., 1st Sess. (1979) 3, 6

Railroad Transportation Policy Act of 1979: Hearings on S. 1946 before the Senate Comm. on Commerce, Science and Transportation, 96th Cong., 1st Sess. (1980) 5

IN THE

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Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF IN OPPOSITION FOR THE RESPONDENT ASSOCIATION OF AMERICAN RAILROADS

This brief is submitted on behalf of the Association of American Railroads,[1] in opposition to the petition for a writ of certiorari filed by Commonwealth Edison Company, et al.

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[1] The Association of American Railroads is a voluntary, unincorporated, non-profit organization composed of member railroad companies operating in the United States, Canada, and Mexico. The Class I member railroads operate 92 percent of the total trackage, employ 94 percent of the workers, and generate approximately 97 percent of the total freight revenues of all railroads in the United States. In addition to the Class I railroads, the AAR represents the interests of several hundred smaller railroads, terminal companies and switching lines.

The Association participated in this case both before the Interstate Commerce Commission, to which it submitted Statements of Fact and Argument, and the Court of Appeals, in which it appeared as Intervenor-Respondent.

STATEMENT OF THE CASE

Petitioners' arguments, even if they had merit, would not warrant grant of a writ of certiorari under the standards established by this Court (Rule 17). There is no conflict among the circuits and no legal issue of general importance in this case that needs to be resolved by this Court. Indeed, the petition raises no substantive legal issue at all. The arguments advanced by Petitioners—that the rail cost index adopted by the Interstate Commerce Commission overstates actual cost increases, and that the Commission abused its discretion in deciding not to require a productivity adjustment as part of the indexing procedure—turn on factual issues. These issues are the subject of a special proceeding, Ex Parte No. 290 (Sub-No. 4), *Railroad Cost Recovery Procedures—Productivity Adjustment*, now being conducted by the Commission. The lack of any need for this Court's review in this case is underscored by the fact that of the eleven sets of shipper parties challenging the Commission's orders in the Court of Appeals, only one now seeks review by this Court.

A. Background of the Staggers Rail Act of 1980

Section 203 of the Staggers Rail Act of 1980, Pub. L. No. 96-448, 94 Stat. 1895, was enacted by Congress to enable the railroads to protect themselves against inflationary cost increases by implementing rate increases with minimal regulatory interference or delay. Congress found, in enacting the Staggers Act, that the revenues of the railroad industry are inadequate. *See* Pub. L. No. 96-448, Section 2. A principal reason why railroad revenues are inadequate is that railroad revenues have not kept pace with inflationary cost increases. For example, between 1969 and 1978, rail costs increased 147 percent while revenue per ton-mile grew by only 76 percent. *See* H.R. Rep. No. 96-1035, 96th Cong., 2d Sess. 106 (1980).

The deteriorated financial condition of the railroad industry underscored the importance of enabling the railroads to recover their increased costs promptly and with minimal regulatory intervention. However, until enactment of the Staggers Act the only broad-scale rate adjustment mechanism available—the so-called "general rate increase"—was cumbersome and time-consuming.[2] The basic flaw in this procedure resulted from the protracted nature of general rate proceedings: general rate increases frequently were not permitted until many months after the railroads had incurred the costs justifying such increases. However, the Interstate Commerce Commission could not authorize retroactive adjustments of rates to recover such increasing costs. Accordingly, the revenues lost by railroads as a result of delays in general rate increase proceedings could never be recovered.[3]

B. Section 203 of The Staggers Act

In enacting Section 203 of the Staggers Rail Act of 1980, Congress created a regulatory mechanism to enable railroads to protect themselves against inflationary cost increases through immediate rate adjustments. Section 203, now codified at 49 U.S.C. § 10707a, directs the

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[2] The evidentiary and procedural requirements imposed by the Commission's regulations governing general rate increase procedures (former 49 C.F.R. § 1102) were extraordinarily complex and burdensome. Satisfying these regulations frequently required railroads to produce thousands of pages of evidence and spend millions of dollars and thousands of manhours for each general rate increase. (Joint Appendix (hereinafter "J.A.") at 210, 419).

[3] The Senate Committee on Commerce, Science and Transportation noted in its report on the Staggers Act that "[t]he railroads' financial difficulties may be attributed, in part, to the time lag involved in recovering cost increases." S. Rep. No. 96-470, 96th Cong., 1st Sess. 19 (1979). The record before the Commission indicates that between June 1978 and July 1980 this time lag inflicted revenue losses on the railroad industry amounting to more than $3.3 billion. (Verified Statement of Dr. Harvey Levine, J.A. 418.)

Commission to develop, maintain and publish an index of rail costs. Section 203 also provides that rate increases no greater than changes in the cost index are immune from challenge by shippers or the Commission. (Section 203, 49 U.S.C. § 10707a(a), (b).)

The amount of the inflation adjustment authorized by Section 203 is determined by multiplying the level of a rate as of a specified date (the "base rate"[4]) by the change in the index since that date (the "rail cost adjustment factor"[5]). The resulting rate level is known as the "adjusted base rate." (49 U.S.C. § 10707a(a)(2)(A).) Congress provided that the railroads "may increase any rate over which the Commission has jurisdiction . . . . so long as the increased rate is not greater than the adjusted base rate . . . ." (49 U.S.C. § 10707a

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[4] The "base rate" is defined at 49 U.S.C. § 10707a(a)(1)(A) as follows:

> " 'base rate' means, with respect to the transportation of a particular commodity (i) for the 24-month period beginning on October 1, 1980, the rate in effect on October 1, 1980, (ii) for the 24-month period beginning on October 1, 1982, the rate in effect on October 1, 1982, and (iii) for the 5-year period beginning October 1, 1984, and for each subsequent 5-year period, the rate in effect on the first day of the applicable 5-year period."

[5] The "rail cost adjustment factor" is defined at 49 U.S.C. § 10707a(a)(2)(B) as follows:

> "(B) Commencing with the fourth quarter of 1980, the Commission shall, as often as practicable but in no event less often than quarterly, publish a rail cost adjustment factor which shall be a fraction, the numerator of which is the latest published Index of Railroad Costs (which index shall be compiled or verified by the Commission, with appropriate adjustments to reflect the changing composition of railroad costs, including the quality and mix of material and labor), and the denominator of which is the same index for the fourth quarter of 1980, or for the fourth quarter of 1982 or for the fourth quarter of every fifth year thereafter, as appropriate."

(b)(1).)[6] The Conference Committee expressly recognized that as a result of this provision, railroads may "change a rate to conform to the 'adjusted base rate' at any time without challenge." (H.R. Rep. No. 96-1430, 96th Cong., 2d Sess. 93 (1980); *see* 49 U.S.C. § 10707a (b)(1) & (2).)

One of the issues given extensive consideration by Congress in drafting Section 203 was the role, if any, of railroad productivity trends in the determination of the rail cost adjustment factor. Section 203 evolved from Section 103 of S. 1946, the Senate bill which ultimately became the Staggers Act. As originally introduced, Section 103 of S. 1946 would *not* have required that the index contain *any* adjustment for productivity changes. During the hearings on S. 1946, shipper representatives testified that Section 103 should be amended to require that the cost index reflect numerous changes in productivity—including those resulting from changes in traffic volume, labor productivity, fuel economy, and traffic mix.[7]

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[6] Section 203 also permits railroads, under certain circumstances, to increase individual rates by as much as four or six percent annually *above* the rate of inflation without risk of suspension by the Commission. This limited protection is subject to several qualifications, however, and shippers may file complaints attacking the increases under 49 U.S.C. § 11701(b). (*See* 49 U.S.C. § 10707a(c)-(e).)

[7] *Railroad Transportation Policy Act of 1979: Hearings on S. 1946 before the Senate Comm. on Commerce, Science and Transportation*, 96th Cong., 1st Sess. 367-557 (1980). For example, Edwin M. Wheeler, President of the Fertilizer Institute (a petitioner in the Court of Appeals) proposed the following amendment to the bill to ensure that these various factors would be "considered in determining the index" (*id.* at 399):

> "Sec. 103 Rail cost adjustment increases
>
> "(f)(3) * * * (add at end of paragraph): This rail cost adjustment factor *shall be adjusted to reflect changes in the productivity of labor, and changes in the volume and mix of traffic.*"

Following these hearings, the Senate Commerce Committee reached a compromise in which it rejected the shipper-proposed mandatory productivity adjustments, but provided for "*appropriate* adjustments to reflect the quality and mix of material and labor . . . ." (*See* S. Rep. No. 96-470, *supra*, at 52; emphasis supplied.)

The Senate Commerce Committee's version of Section 103 was included in the bill which was passed by the Senate and referred to the Conference Committee on S. 1946. The Conference Committee included the Senate language in Section 203 of the Staggers Act, adding an additional phrase:

> "Commencing with the fourth quarter of 1980, the Commission shall . . . . publish a rail cost adjustment factor which shall be a fraction, the numerator of which is the latest published Index of Railroad Costs (which index shall be compiled or verified by the Commission, with appropriate adjustments to reflect *the changing composition of railroad costs, including* the quality and mix of material and labor) . . . ." (H.R. Rep. No. 96-1430, *supra*, at 8; additional phrase underscored.)

Thus, the Conference Committee adhered to the approach adopted by the Senate; instead of requiring a broad range of adjustments to reflect changes in productivity (as advocated by shipper representatives), the Conference Committee settled the matter by providing that the quarterly index adopted by the Commission should include "appropriate adjustments to reflect the changing composition of railroad costs, including the quality and mix of material and labor . . . ."

C. Proceedings Before The Commission

Two months after the Staggers Act became effective, the Commission issued a Notice of Proposed Rulemaking ("NPR") to implement Section 203 of the Staggers Act. (Ex Parte No. 290 (Sub-No. 2), *Procedure Governing General Rate Increase Proceedings; Railroad Cost Recov-*

ery Procedures, 45 Fed. Reg. 81217 (December 10, 1980).) In this NPR, the Commission proposed to comply with Section 203 by adopting a modified version of the existing rail cost index developed by the Association of American Railroads (AAR), and by using this index as the basis for inflation-based rate increases under Section 203. (*Id.* at 81217-18.)

The Commission explained in the NPR its reasons for proposing to adopt the AAR index and described how it planned to monitor and audit the indexing process. The Commission also explained why, in its view, the index need not include productivity adjustments other than adjustments to reflect the changing composition of rail costs. (45 Fed. Reg. at 81218).

After receiving a further round of written comments from interested parties, the Commission served its final decision in Ex Parte No. 290 (Sub-No. 2) on April 17, 1981. (364 I.C.C. 841; Pet. App.[8] A.) That decision, which was reviewed by the Court of Appeals below, adopted essentially unchanged the indexing procedures proposed in the Commission's earlier NPR. In its decision, the Commission further considered the productivity issue and reaffirmed its previous conclusion that Section 203 of the Act, in providing for "appropriate adjustments to reflect the changing composition of railroad costs . . .", required only adjustments to account for changes in the relative weighting of the cost components covered by the index.

Apart from adjustments to the weightings applied to the input costs, the Commission decided that no further adjustment was necessary. In particular, it rejected the shippers' contention that the AAR index, which was an index of the changing costs of *inputs* (such as labor, fuel, and materials), must be adjusted for productivity changes

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[8] The term "Pet. App." refers to the Appendices filed by Petitioners in this Court.

in order to produce an index of costs of *outputs* (such as unit cost per ton-mile). The Commission noted that the Act itself did *not* require such further adjustment (364 I.C.C. at 846; Pet. App. C-6).

> "At the outset, we note that the Rail Act does not specify whether an input cost index or an output cost index is to be used as the rail cost adjustment factor. Instead, the Rail Act leaves this matter up to the Commission, as a matter of policy, to be determined in a manner consistent with the purpose of the Rail Act as a whole."

In the absence of any *requirement* of a productivity adjustment in Section 203, the Commission noted the "methodological problems" of productivity measurement, and decided not to require any such adjustment—a decision which it believed was most consistent with "the purpose of Section 203", and which would permit the railroads "to neutralize the effects of inflation through rate increases with minimal regulatory intervention." (*Id.* at 846.)

On the date the Commission's decision was served, Western Coal Traffic League filed the first of eleven petitions for review of the decision.[9]

D. The Decision of the Court of Appeals

The Court of Appeals for the D.C. Circuit affirmed the Commission's decision. *Western Coal Traffic League* v. *United States*, 677 F.2d 915 (D.C. Cir. 1982) (Pet. App. A.) The court's decision addressed and resolved two ques-

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[9] The eleven groups of shippers filing petitions for review with the Court of Appeals were: Western Coal Traffic League; Fort Howard Paper Company; Commonwealth Edison Company, et al.; Edison Electric Institute; The Fertilizer Institute; Carolina Power and Light Company, et al.; Alabama Power Company, et al.; Chemical Manufacturers Association; Central Illinois Light Company, et al.; American Paper Institute, Inc.; and South Carolina Electric & Gas Co. (Pet. App. A-1 - A-4.)

tions: (1) whether the ICC correctly decided that Section 203 of the Staggers Act left the Commission discretion as to whether to make productivity adjustments in formulating its cost index; and (2) if Section 203 did not mandate productivity adjustments, whether the Commission acted reasonably in deciding not to adjust the AAR index to reflect productivity changes.

The Court of Appeals analyzed the first question in light of the express requirement of Section 203 that the cost index adopted by the Commission

> "be compiled or verified by the Commission, with *appropriate* adjustments to reflect the changing composition of railroad costs, including the quality and mix of material and labor." (Emphasis supplied.)

Based on this language, the court rejected the argument that Section 203 *requires* that the index be adjusted to reflect productivity changes (Pet. App. A-18):

> "Since one critical issue in this case is whether estimates of productivity gains on a quarterly basis are feasible, CMA's contention that productivity is a cost factor, even if accepted, is insufficient to prove that a productivity adjustment is 'appropriate' and, therefore, statutorily mandated."

The court also rejected the argument that the legislative history of Section 203 compelled the Commission to make productivity adjustments (Pet. App. A-22):

> "In this case, the legislative record supports an inference that the committee redrafted section 203 in response to the shippers' testimony, but it collapses as a foundation for understanding how the committee chose to resolve the conceptual and methodological problems of cost indexing. It is possible that the committee sought to accommodate the shippers' concerns, viewing language on the quality and mix of labor and materials as a general formulation of the kind of adjustments needed to make an input index accurately reflect costs per unit of output. Alternatively, the committee may have sought to

> reaffirm the approach of the original bill, requiring only those refining adjustments that fit easily within an input methodology. Neither the committee's rejection of the bill's original language, nor its rejection of the shippers' proposed amendment provides a reliable basis for choosing between these two readings."

The court concluded that in light of the underlying purposes of Section 203, the Commission was *not* required to make productivity adjustments in its rail cost index (Pet. App. A-25):

> "Thus, while we agree with petitioners that the purpose of section 203 was to allow railroads to keep up with cost increases, we cannot conclude that this purpose mandates adoption of an output index regardless of the accuracy of such an index or the feasibility of designing it so as to allow railroads to obtain rate increases in a timely manner."

The court thus ruled that Congress, in enacting Section 203, had left to the Commission's discretion whether to make productivity adjustments in computing the rail cost adjustment factor.

The Court of Appeals then turned to the second question, whether the Commission had acted reasonably in declining to adjust the cost index to reflect productivity changes. The court noted that the record supported the Commission's assessment of "the unreliability of productivity measures." (Pet. App. A-28.) The court also concluded that "the record does *not* support the shippers' assertion that productivity will always grow at some minimum rate." (Emphasis supplied.) (Pet. App. A-28.) In light of these findings, the Court of Appeals found to be reasonable the Commission's decision not to adopt a productivity adjustment and thereby "risk the possibility of overdeflating the cost index at times when railroads are also suffering adverse effects of the business cycle." (Pet. App. A-31.)

In affirming the Commission's decision, the Court of Appeals noted with approval the Commission's "stated intention to review the index against current cost data, taking appropriate action in the event of overrecovery . . ." (Pet. App. A-31.)

E. Further Proceedings Before The Commission

In fulfillment of its "stated intention," the Commission on July 14, 1982, issued an "Advance Notice of Proposed Rulemaking" requesting comments on the possible use of a productivity adjustment in determining the quarterly rail cost adjustment factor, and proposals for measuring productivity and for implementing a productivity adjustment. Ex Parte No. 290 (Sub-No. 4), *Railroad Cost Recovery Procedures—Productivity Adjustment.* (47 Fed. Reg. 32176; Pet. App. E-1.) Comments are presently due to be submitted to the Commission on or before October 25, 1982.

ARGUMENT

Petitioners' request that this Court review the Court of Appeals' decision affirming the Commission's cost index procedures should be denied. The petition totally fails to satisfy the standards established by this Court for review on writ of certiorari. Rule 17 of the Rules of the Supreme Court states that certiorari will be granted "only where there are special and important reasons therefor," as "[w]here a court of appeals has rendered a decision in conflict with the decision of another court of appeals on the same matter . . . or has decided an important question of federal law which has not been, but should be, settled by this Court."

There is no conflict between the decision of the Court of Appeals below and that of any other court. Nor is there any question of federal law which need be resolved by this Court. The arguments made by Petitioners—that the cost index overstates actual cost increase, and that Commission should have adopted a productivity adjustment—are currently the subject of a special proceeding

being conducted by the Commission. (*See* Pet. App. E.) Petitioners and others thus have ample opportunity to present their evidence and arguments to the Commission with respect to the productivity issue.

Moreover, as explained below, the decision of the Court of Appeals affirming the Commission's order was clearly correct. Indeed, the basic arguments made by Petitioners are not legal arguments at all, but are instead premised on factual assertions which are totally unsupported, and which in some instances were explicitly considered and rejected by the Commission and the Court of Appeals.

Finally, Petitioners' contention that "in terms of its effect on shippers, this may well be the most important transportation case this Court has ever been asked to review" (Pet. 12) not only reflects an unenlightened view of this Court's history, but is belied by the fact that of the eleven sets of parties challenging the Commission's orders in the Court of Appeals, *only one* group is seeking review by this Court.

1. First, Petitioners assert that by not requiring the Commission to make a productivity adjustment, the Court of Appeals allowed the Commission to "adopt knowingly and deliberately an index that greatly overstates increases in costs." (Pet. 7.) Petitioners' assertion is both unsupported by the record and incorrect. The issue before the Commission was whether the use of an input cost index such as the AAR index (and such as the Producer Price Index and the Consumer Price Index issued by the United States Bureau of Labor Statistics) is appropriate to measure inflation in railroad costs—or whether, as the shippers asserted, the input index should be adjusted for productivity changes to produce what they termed an "output cost index." The railroads submitted extensive and detailed evidence to the Commission showing that use of an input cost index was appropriate, and that the AAR index was an accurate measure of the changing costs of railroad inputs, such as labor, fuel, and materials. The Commission concluded that the use of an input cost index was proper, and that the AAR index accurately measured

changes in the costs of such inputs (Pet. App. C-3 - C-4). Petitioners' contention as to deliberate cost overstatement is based on the implicit premise that the cost changes to be measured are those in outputs, rather than inputs—even though that premise was shown to be incorrect below, and was flatly rejected by the Commission; and the Commission's decision was affirmed by the Court of Appeals.[10]

Moreover, Petitioners' assertion that the absence of a productivity adjustment causes a "great" or "substantial" difference between the index of changes in input costs and output unit costs was the subject of controversy before the Commission. The railroads submitted evidence that Petitioners' assertion was not correct, and the Commission expressly rejected the methodology upon which Petitioners' assertion was premised.[11] Petitioners' conten-

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[10] The Court of Appeals held that the Commission's obligation "was to assure that the index did not contain unreasonable biases." (Pet. App. A-25 - A-26 n.27.) The court found that "[t]he Commission fulfilled this obligation by reviewing the AAR index's methodology and making appropriate adjustments to reflect the composition of railroad costs." (Pet. App. A-26.) Thus, Petitioners' contention that the index adopted by the Commission overstates costs is unfounded and was squarely rejected by the Court of Appeals.

[11] In support of their assertion that "[t]he uncontradicted evidence in the record is that the overstatement of cost [by the AAR Index] is substantial" (Pet. 7 n.6.), Petitioners refer to various cost indices indicating smaller annual increases in railroad costs than those reflected by the AAR Index. The comparisons relied upon by Petitioners are invalid. As Petitioners' *own cost witness* acknowledged, the comparisons in one instance rely on figures which do *not* reflect the effect of year-to-year changes in the mix of traffic (J.A. 816), and in other instances rely on indices which do not even relate to changes in *railroad* costs. (J.A. 819.) As the Court of Appeals correctly noted (Pet. App. A-17), no party proposed use of an index other than the AAR Index; the shippers merely sought to have that index adjusted to reflect productivity changes. Yet, the Commission found and the Court of Appeals affirmed that the record contains ample support for the conclusion that the methods suggested by shippers for measuring productivity changes produced distorted and unreliable figures, often due to the improper use of

tion that the Commission "knowingly" adopted a methodology that "greatly overstates" cost increases is thus both misleading and totally unfounded.

2. Petitioners also contend that the Court of Appeals, in reviewing the record with respect to the difficulties of accurately measuring changes in productivity, erred by substituting "its own views" for those of the Commission, and by affirming the Commission's decision on a ground upon which the Commission had not relied. (Pet. 8.) Petitioners assert that the Commission "conceded" that the development of productivity measures is "feasible," and that the Court of Appeals simply substituted its own factual findings as to the difficulties of measuring changes in productivity. (Pet. 7-8.) Petitioners' contention is again simply belied by the facts.

In its Notice of Proposed Rulemaking, the Commission advanced the proposition that "there is *no acceptable measure* of productivity available." (Emphasis supplied; 45 Fed. Reg. 81214; J.A. 601.) In its final decision (which was the subject of review below), the Commission did *not* find (or "concede") that the development of productivity measures is "feasible." Instead, although noting that the methodological problems of productivity management do "not preclude" the development of such measures, it observed that such problems were "grave,"; and

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the ton-mile as the single-factor measure of output. (*See* J.A. 511-15; 857-60.)

Petitioners' further contention that the "Western railroads" have "conceded" that the AAR Index "overstates railroad costs by 25% by basing escalation agreements on 80% of the Index" (Pet. 7 n.6) is simply untrue. These asserted agreements (principally involving a single western carrier) with respect to rate escalation (principally with regard to a single category of traffic—coal moved in unit trains) involved many factors other than rate levels. The fact that a compromise may be negotiated by one railroad, in the case of one commodity, with respect to one component of an escalation formula, does not support any conclusion as to the appropriateness of such an adjustment for measuring the effect of total railroad productivity changes on total railroad costs.

it concluded, "[w]e . . . question the reliability of such measures and as a matter of policy do not believe that their use is justified." (Pet. App. C-6.)

The Court of Appeals, in affirming the Commission's decision, referred specifically to *these* findings *by the Commission* (Pet. App. A-28-29):

> "The crux of *the Commission's rationale* is that available productivity measures are sufficiently unreliable, and the consequences of overestimating productivity growth are sufficiently grave, that it is inappropriate to adjust the cost index on the assumption of continued productivity growth. *The Commission's assessment* of the unreliability of productivity measures finds support in the record." (Emphasis supplied.)

Thus, the Court of Appeals clearly relied upon the Commission's findings in affirming its decision. Petitioners' contention to the contrary is demonstrably incorrect.

3. Petitioners also challenge the Court of Appeals' reference to the Commission's commitment to follow through on its "stated intention to review the index against current cost data, taking appropriate action in the event of overrecovery. . ." (Pet. App. A-31.) Petitioners contend that the Commission's statement of intention "is a far cry from a commitment to determine whether the AAR Index overstates cost increases and to take action in the event of overrecovery." (Pet. 8.)

Petitioners' dissatisfaction with the court's asserted misreliance on the Commission's stated intentions is baseless. The court's reference to the Commission's intention was not central to the court's decision, which was primarily founded on the court's conclusion that the cost indexing procedures adopted by the Commission were reasonable. Moreover, Petitioners' dissatisfaction is irrelevant because the Commission has now commenced a proceeding by issuing a notice of proposed rulemaking deal-

ing specifically and solely with the productivity issue, Ex Parte No. 290 (Sub-No. 4), *Railroad Cost Recovery Procedures—Productivity Adjustment.* As part of that notice, the Commission requested "comments on the possible use of the productivity adjustment in determining the quarterly rail cost adjustment factor and proposals for measuring productivity and for implementing a productivity adjustment." (Pet. App. E-3.) The Commission is receiving comments on the productivity issue through October 25, 1982.

Thus, whether the ICC's statement of its intentions was a binding commitment or not, the Commission *is following through* on that statement. Whether Petitioners or any other party will be satisfied by the Commission's decision is, of course, entirely speculative. However, the Commission is clearly living up to its commitment to review the current index and to afford all interested parties an opportunity to submit evidence and argument with respect to the productivity issue.

4. Finally, Petitioners argue that the present case is of "supreme importance" to shippers of commodities "that are captive to the railroads." (Pet. 9.) In support of this point, Petitioners present an *entirely hypothetical* set of numbers (Pet. 9-10) generated on the assumption that the cost index used by the Commission is and will continue to be 25 percent higher than "actual costs."

Petitioners' assertion concerning the importance of this case to shippers is contradicted by the fact that only one of the eleven sets of shippers who challenged the Commission's decision in the Court of Appeals has sought review of that court's decision here. Moreover, Petitioners' assumption that the cost index used by the Commission has overstated, and will continue to overstate, costs by 25 percent is not based on anything in the record. Nor is Petitioners' chart showing the asserted consequences of such alleged overstatement a part of the record. Indeed, to the extent that Petitioners' hypothetical rests on the as-

sumption that the index used by the Commission has overstated costs by 25 percent, the hypothetical is *contradicted* by the record.[13]

CONCLUSION

Petitioners' arguments clearly do not warrant grant of a writ of certiorari under the standards established by Rule 17 of the Rules of this Court. The issue of whether the Commission should make a productivity adjustment in determining the quarterly rail cost adjustment factor is the subject of a special rulemaking proceeding currently being conducted by the Commission. Moreover, the contentions that the court below erred in affirming the Commission's decision are based not on legal arguments but on factual assertions which are both unsupported by the record and wrong.

For those reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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[13] *See* footnote 11 *supra* at 13-14.